# Jurisdictional Statement

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# In the Supreme Court of the United States

OCTOBER TERM, 1980

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UNITED STATES OF AMERICA, APPELLANT

*v.*

SECURITY INDUSTRIAL BANK, ET AL.

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*ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

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## JURISDICTIONAL STATEMENT

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## QUESTION PRESENTED

Whether Section 522(f)(2) of the Bankruptcy Code, 11 U.S.C. (Supp. III) 522(f)(2), as applied to certain nonpossessory, nonpurchase-money security interests acquired before its enactment, violates the Fifth Amendment.

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## JURISDICTIONAL STATEMENT

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* The judgment of the court of appeals embraces seven different cases filed in bankruptcy courts and consolidated on appeal (Nos. 80-1549 through 80-1553, 80-2267, 80-2268). The United States intervened in these cases in the bankruptcy courts pursuant to 28 U.S.C. 2403(a). Freedom Finance, Liberty Loan Corporation and Beneficial Finance of Kansas, Inc., were defendants in the bankruptcy court proceedings and are appellees here. The debtors, the plaintiffs in the bankruptcy court proceedings, are Donald Lee Rodrock, Janet Carol Rodrock, Pamela Sue Knezel, Rosemary Louise Hoops, Noval James Jackson, Jerrie Jackson, Paul Leroy Stevens, Sara Ann Stevens, Randall Dean Schulte, Ollie Denise Schulte (a/k/a Ollie Denise Dehne), Richard Glen Hunter and Sharon Kay Hunter. They are nominally appellees in this Court although they did not participate in this case in the court of appeals.

## OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-12a) is reported at 642 F.2d 1193. The opinion of the bankruptcy court in *Rodrock* and *Knezel* (App. C, *infra*, 16a-27a) is reported at 3 Bankr. Rep. 629. The opinion of the bankruptcy court in *Hoops* (App. D, *infra*, 28a-40a) is reported at 3 Bankr. Rep. 635. The opinion of the bankruptcy court in *Jackson* and *Stevens* (App. E, *infra*, 41a-51a) is reported at 4 Bankr. Rep. 293. The opinion of the bankruptcy court in *Schulte* and *Hunter* (App. F, *infra*, 52a-59a) is reported at 8 Bankr. Rep. 12.

## JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 13a-15a) was entered on March 2, 1981. The notice of appeal (App. G, *infra*, 60a) was filed on April 1, 1981. On May 21, 1981, Justice White extended the time for docketing the appeal to and including July 30, 1981 (App. H, *infra*, 61a). Federal jurisdiction in the bankruptcy court was invoked under 28 U.S.C. (Supp. III) 1471. The jurisdiction of this Court is invoked under 28 U.S.C. 1252. *Parker* v. *Levy*, 417 U.S. 733, 742-743 n.10 (1974).

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Article I, Section 8, Clause 4 of the United States Constitution provides:

> The Congress shall have Power * * * [t]o establish * * * uniform Laws on the subject of Bankruptcies throughout the United States.

2. The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall * * * be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

3. Section 522(f)(2) of the Bankruptcy Code, 11 U.S.C. (Supp. III) 522(f)(2), provides:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—
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> * * * * *
>
> (2) a nonpossessory, nonpurchase-money security interest in any—
>
> (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
>
> (B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or
>
> (C) professionally prescribed health aids for the debtor or a dependent of the debtor.

4. Section 522(d) of the Bankruptcy Code, 11 U.S.C. (Supp. III) 522(d), provides in pertinent part:

> The following property may be exempted under subsection (b)(1) of this section:
>
> * * * * *

(3) The debtor's interest, not to exceed $200 in value in any particular item, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor.

(4) The debtor's aggregate interest, not to exceed $500 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

* * * * *

(6) The debtor's aggregate interest, not to exceed $750 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.

* * * * *

(9) Professionally prescribed health aids for the debtor or a dependent of the debtor.

## STATEMENT

1. In 1978, Congress enacted a comprehensive revision of the federal bankruptcy laws. Pub. L. No. 95-598, 92 Stat. 2549. One of the major goals of the bankruptcy revision was to redesign traditional bankruptcy protections for consumer debtors. See 123 Cong. Rec. 35444 (1977). Because the existing bankruptcy laws primarily had been concerned with business bankruptcies, Congress found that they had been unsuccessful in affording a "fresh start" to consumer debtors, who often came through bankruptcy "little better off than they were before." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 116-117 (1977). To avoid that result, Congress enacted Section 522(d) of the new Bankruptcy Act to establish a set of federal exemptions, which identify the property that a

debtor may exclude from the bankrupt estate.[1] Examples of the items of property subject to exemption, up to a specified dollar limit, are the debtor's residence, motor vehicle, furniture, clothing and professional books. See 11 U.S.C. (Supp. III) 522(d)(1), (2), (3), (6).

The provision at issue here, Section 522(f), was enacted to protect the most essential of these exemptions by enabling the debtor to avoid a narrow category of liens that could render the exemptions meaningless. Section 522(f)(1) permits the debtor to avoid the fixing of a judicial lien on exempt property. Section 522(f)(2) permits the debtor to avoid the fixing of a nonpossessory, nonpurchase-money security interest in certain exempt property. Section 522(f)(2) does not extend to all property exempted under Section 522(d); it is limited to certain specified personal items, such as household furnishings, tools of the debtor's trade, and professionally prescribed health aids.[2] By its terms, Section 522(f) has no application to a possessory interest in the debtor's property or to a purchase-money security interest, such as the security interest retained by a

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[1] Upon commencement of a bankruptcy proceeding, the debtor's legal and equitable property interests are transferred to a separate estate from which claims are satisfied. See 11 U.S.C. (Supp. III) 541. Under Section 522(b), however, a debtor may exempt from the estate either property that is exempt from execution under state law or property that is defined as exempt under federal law.

[2] The items covered by Section 522(f)(2) correspond to the exemptions of Sections 522(d)(3), (4), (6) and (9). All of the property involved in this case apparently falls within Section 522(d)(3) (exempting household and personal items valued at $200 or less).

seller when he accepts payment for exempt property on an installment basis.[3]

2. This case involves seven different suits brought in four different bankruptcy courts, which were consolidated on appeal in the Tenth Circuit because they present identical issues. In each case, a creditor had acquired a nonpossessory, nonpurchase-money security interest in the debtor's household furnishings and appliances before the President signed into law the Bankruptcy Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, on November 6, 1978 (App. A, *infra*, 5a). In each case, the debtor instituted bankruptcy proceedings after October 1, 1979, the effective date of the Act,[4] claiming exemptions for items that were subject to the creditor's security interest (*ibid.*). When the creditors objected to these claimed exemptions, the debtor in each case filed a complaint in the bankruptcy court pursuant to Section 522(f)(2), seeking to avoid the creditor's lien (*ibid.*). In each instance, the creditor moved to dismiss the debtor's complaint, asserting that application of Section 522(f) to a security interest acquired before enactment of that provision violated the Fifth Amendment (*ibid.*).

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[3] The Bankruptcy Code does not define "purchase-money security interest." Under the Uniform Commercial Code, purchase-money security interests are interests retained by sellers or interests that otherwise secure the obligation that financed the acquisition of the encumbered property. See U.C.C. § 9-107.

[4] Section 402(a) of the Act, 92 Stat. 2682, made the Act effective as of October 1, 1979, with certain exceptions that are not relevant here. Bankruptcy proceedings commenced after that date ordinarily are to be governed by the new Bankruptcy Code; proceedings commenced before that date continue to be governed by the old Bankruptcy Code.

Pursuant to 28 U.S.C. 2403(a), the United States was notified that the constitutionality of a federal statute had been drawn into question, and the United States intervened in each bankruptcy court to defend the constitutionality of the statute. In all cases, the bankruptcy court dismissed the debtor's complaint. In *Rodrock* v. *Security Industrial Bank* and *Knezel* v. *Security Industrial Bank* (App. C, *infra*, 16a-27a), the bankruptcy court concluded that the creditor's due process rights were violated because its pre-existing "substantive right in specific property" had been "substantially impaired" (*id.* at 20a-21a, 24a). In *Hoops* v. *Freedom Finance and Security Industrial Bank* (App. D, *infra*, 28a-40a), the bankruptcy court concluded that Section 522(f), as applied retrospectively to pre-enactment liens, violated "substantive due process" (*id.* at 32a, 39a), while noting that the Just Compensation Clause did not appear to be involved in the case (*id.* at 29a-30a). In *Jackson* v. *Security Industrial Bank* and *Stevens* v. *Liberty Loan Corp.* (App. E, *infra*, 41a-51a), the bankruptcy court concluded that Section 522(f), as applied retrospectively, violated the due process clause of the Fifth Amendment (*id.* at 51a). In *Schulte* v. *Beneficial Finance of Kansas, Inc.* and *Hunter* v. *Beneficial Finance of Kansas, Inc.* (App. F, *infra*, 52a-59a), the bankruptcy court noted that retrospective application of Section 522(f) created constitutional problems (*id.* at 56a-57a) and concluded that the statute should be applied only to security interests created subsequent to October 1, 1979 (*id.* at 59a). All four decisions relied heavily on this Court's decision in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935) (see App. C, *infra*, 18a-25a; App. D, *infra*, 29a-39a; App. E, *infra*, 47a-51a; App. F, *infra*, 56a-57a).

The court of appeals affirmed (App. A, *infra*, 1a-11a). Disagreeing with the bankruptcy court in *Schulte* and *Hunter*, the court held that Congress intended the Bankruptcy Act to apply retrospectively and thus that Section 522(f) must be applied to pre-enactment security interests in bankruptcy proceedings commenced after October 1, 1979 (*id.* at 7a-9a). Relying on *Radford*, however, the court concluded that such retrospective application was unconstitutional (*id.* at 9a-11a). The court did not explicitly state which clause of the Fifth Amendment was violated, although it did note that Section 522(f) effected a "complete taking of the secured creditors' property interests" in these cases (*id.* at 10a).

## THE QUESTION IS SUBSTANTIAL

1. The constitutionality of Section 522(f)(2), as applied retrospectively, has been the subject of a flood of litigation. Although the decision below is the first by a court of appeals, the issue has sharply divided bankruptcy courts all over the country.[5] Ap-

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[5] Bankruptcy courts that have held Section 522(f)(2) constitutional as applied to pre-enactment security interests include: *Morris* v. *Associates Fin. Cos.*, Nos. 79-B-39137 and 80-A-63 (N.D. Ill. June 24, 1981); *Paden* v. *G.E.C.C. Consumer Discount Co.*, 10 Bankr. Rep. 206 (E.D. Pa. 1981); *Stump* v. *Beneficial Fin. Co.*, 8 Bankr. Rep. 516 (D.S.D. 1981); *Campbell* v. *Avco Fin. Servs.*, 8 Bankr. Rep. 425 (S.D. Ohio 1981); *Pillow* v. *Avco Fin. Servs.*, 8 Bankr. Rep. 404 (D. Utah 1981); *Sweeney* v. *Pac. Fin. Co.*, 7 Bankr. Rep. 814 (E.D. Wis. 1980); *Joyner* v. *Golden Dome Inv. Co.*, 7 Bankr. Rep. 596 (M.D. Ga. 1980); *In re Goodrich*, 7 Bankr. Rep. 590 (S.D. Ohio 1980); *Brown* v. *Termplan*, 7 Bankr. Rep. 264 (N.D. Tex. 1980); *Fisher* v. *Liberty Loan Corp.*, 6 Bankr. Rep. 206 (N.D. Ohio 1980); *In re Primm*, 6 Bankr. Rep. 142 (D. Kan. 1980); *Baker* v. *GFC Corp.*, 5 Bankr. Rep. 397 (W.D. Mo. 1980); *Curry* v. *Associates Fin. Servs.*, 5 Bankr.

peals raising issues identical to or closely related to the issue in this case are now pending in four other circuits.[6]

Moreover, the issue is of substantial importance. A section of an Act of Congress that was considered critical to the achievement of one of the statute's ma-

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Rep. 282 (N.D. Ohio 1980); *In re Middleton*, 7 Bankr. Rep. 3 (N.D. Ga. 1980); *Centran Bank* v. *Ambrose*, 4 Bankr. Rep. 395 (N.D. Ohio 1980); *Rutherford* v. *Associates Fin. Servs.*, 4 Bankr. Rep. 510 (S.D. Ohio 1980).

Bankruptcy courts that have held Section 522(f)(2) unconstitutional as applied to pre-enactment security interests include: *In re Bibb*, 10 Bankr. Rep. 40 (E.D. Mich. 1981); *Sams* v. *Avco Fin. Servs.*, 9 Bankr. Rep. 479 (N.D. Ohio 1981); *Hammer* v. *Beneficial Fin. Co.*, 9 Bankr. Rep. 343 (N.D. Iowa 1981); *Felmey* v. *Household Fin. Corp.*, 9 Bankr. Rep. 331 (E.D. Va. 1981); *Cashion Community Bank* v. *Carnes*, 8 Bankr. Rep. 599 (W.D. Okla. 1981); *Oldham* v. *Beneficial Fin. Co.*, 7 Bankr. Rep. 124 (D.N.M. 1980); *Hawley* v. *Avco Fin. Servs.*, 4 Bankr. Rep. 147 (D. Or. 1980).

A few bankruptcy courts have avoided the constitutional question by holding that Congress did not intend Section 522(f) to apply to pre-enactment liens. See *Malpeli* v. *Beneficial Fin. Co.*, 7 Bankr. Rep. 508 (N.D. Ill. 1980); *Pierce* v. *Oklahoma Health Servs. Fed. Credit Union*, 4 Bankr. Rep. 671 (W.D. Okla. 1980); *In re Pape*, 7 Bankr. Rep. 443 (N.D. Fla. 1980).

[6] The precise issue presented here is pending before the Seventh Circuit in *Willis R. Gifford, et al.* v. *Thorp Fin. Corp.*, No. 81-1174, and before the Fourth Circuit in *United States* v. *Security Pacific Fin. Co.*, Nos. 81-1221 and 81-1266. A case involving the constitutionality of avoidance of a security interest created after the enactment of the Bankruptcy Act but before its effective date is pending in the Ninth Circuit. *Harry George Weber, et al.* v. *Credithrift of America, Inc.*, Nos. 81-3055, 81-3128. A case involving the constitutionality of Section 522(f)(1), which provides for avoidance of judicial liens on exempt property, is pending in the Third Circuit. *In re Ashe*, No. 81-1629.

jor purposes has been declared unconstitutional as applied to a large class of bankruptcies. The Report of the Commission on the Bankruptcy Laws of the United States ("Commission Report") recommended inclusion of this provision to make debtor exemptions effective (H.R. Doc. No. 93-137 (Pt. 1), 93d Cong., 1st Sess. 170 (1973)), and Congress found that Section 522(f) was essential to protect "the debtor's exemptions, his discharge, and thus his fresh start." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 362 (1977). See also *id.* at 117, 126-127. While the importance of the issue presented can be expected to diminish over time as the number of outstanding pre-enactment liens declines, resolution of the issue has substantial practical significance for a large number of creditors and debtors and for a large number of pending cases.

2. The decision of the court of appeals takes an unduly narrow view of Congress's bankruptcy power. This Court has long recognized the breadth of Congress's power under the Bankruptcy Clause, noting that "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law." *Hanover Nat'l Bank* v. *Moyses*, 186 U.S. 181, 192 (1902). Of course, that power is not completely unfettered. As this Court stated in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 589 (1935), the bankruptcy power is "subject to the Fifth Amendment." But *Radford* is the only case in which this Court has held bankruptcy legislation to violate the Fifth Amendment. On many occasions, this Court has recognized that, in at least some instances, liens and secured claims may be voided, limited or subordinated to other interests by a bankruptcy court (see, *e.g.*, *New Haven Inclu-*

*sion Cases*, 399 U.S. 392, 490-492 (1970); *American Surety Co.* v. *Sampsell*, 327 U.S. 269 (1946); *Pepper* v. *Litton*, 308 U.S. 295, 312 (1939); *Local Loan Co.* v. *Hunt*, 292 U.S. 234 (1934); *Chicago, Burlington & Quincy R.R.* v. *Hall*, 229 U.S. 511 (1913)) and has upheld legislation that impaired the value of liens (see, *e.g.*, *Wright* v. *Union Central Life Ins. Co.*, 311 U.S. 273 (1940); *Wright* v. *Vinton Branch*, 300 U.S. 440 (1937)). Against this background, it is apparent that *Radford* should be viewed in its specific factual context, and cannot be read broadly to foreclose Congress's power to impose reasonable limits on the interests of lienholders under the plenary bankruptcy power.

The court of appeals interpreted *Radford* as drawing a rigid line, for Fifth Amendment purposes, between interests in "specific property" and other contractual interests.[7] However, this Court has held that a bankruptcy court may apply principles of law that retrospectively invalidate liens on specific property—a debtor's future wages. *Local Loan Co.* v. *Hunt*, *supra*. Nor can *Radford* reasonably be read as drawing a line between tangible property interests and other property interests such as monetary claims. Clearly, the protections of the Fifth Amend-

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[7] The court of appeals did not explain whether its decision rested on the Due Process Clause or the Just Compensation Clause, although it is clear that the court relied chiefly on *Radford*. It is immaterial, for present purposes, whether the issue in this case is analyzed under the Just Compensation Clause (see *Louisville Joint Stock Land Bank* v. *Radford*, *supra*, 295 U.S. at 601-602) or the Due Process Clause (see *Wright* v. *Union Central Ins. Co.*, 304 U.S. 502, 515 & n.17, 517-518 & n.23 (1938)). Neither provision justifies the result reached by the court of appeals or suggests that *Radford* was properly applied here.

ment are not limited to tangible property (see, *e.g.*, *Arnett* v. *Kennedy*, 416 U.S. 134, 154-155 (1974)), and there is no reason to apply such a limitation in this context. See, *e.g.*, Countryman, *Treatment of Secured Claims in Chapter Cases*, 82 Com. L. J. 349, 359-360 (1977); Martin, *Substantive Regulation of Security Devices Under the Bankruptcy Power*, 48 Colum. L. Rev. 62, 71-74 (1948). Rather, the bankruptcy power permits Congress, within reasonable limits, to enact legislation that affects creditors' interests—interests that ordinarily are characterized as property interests. *Radford* simply stands for the proposition that Congress exceeded those reasonable limits in the specific context of that case.

The Court in *Radford* identified the question before it as whether the statute at issue, the Frazier-Lemke Act, had taken from the plaintiff without compensation "rights in specific property which are of substantial value." 295 U.S. at 601. The security interest involved in *Radford* was the strongest imaginable, a mortgage in real property, and the Court held that the substantial impairment of that interest by the Frazier-Lemke Act violated the Fifth Amendment.[8]

Analysis of the fundamental differences between the security device at issue here and the traditional real estate mortgage demonstrates that *Radford* is not controlling in this case. See, *e.g.*, *Pillow* v. *Avco Fin. Servs.*, 8 Bankr. Rep. 404, 418-420 (D. Utah 1981). Congress has prescribed that a debtor may avoid only the particular type of security interest specified in Section 522(f). Congress's pertinent find-

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[8] As amended, the Frazier-Lemke Act was later upheld by this Court because the amended Act effected a lesser impairment of mortgage rights. *Wright* v. *Vinton Branch*, *supra*.

ings establish that, unlike a real estate mortgagee, the holder of a nonpossessory nonpurchase-money security interest in household furnishings or other personal possessions has little basis for expecting to repossess or realize on such property. These security interests ordinarily are created when "creditors lending money to a consumer debtor take a security interest in all of the debtor's belongings." H.R. Rep. No. 95-595, *supra*, at 127; see also Statement of David H. Williams, reprinted at Appendix I, *id.* at 166, 171-172. Congress determined that such security interests do not have the same "substantial value" as the mortgage interest considered in *Radford*. To the contrary, Congress found that personal consumer property is of little value to creditors due to its limited resale value, and thus presents "a special case" (*id.* at 172). Congress also characterized security interests on personal consumer property as "contract[s] of adhesion" (H.R. Rep. No. 95-595, *supra*, at 127). It noted that the threat of repossession of highly personal possessions enables creditors to exercise coercive power disproportionate to their economic interests and forces debtors into making payments that they cannot afford (*ibid.*). In view of the special problems created by nonpossessory, nonpurchase-money consumer liens, and in view of the relatively small economic interest of creditors in the collateral, Congress fashioned a lien avoidance provision that, within narrowly defined dollar limitations, removes certain personal possessions from the coverage of such liens and, at least in part, gives effect to the statutory exemptions prescribed in the bankruptcy statute.

Apart from the special nature of nonpossessory, nonpurchase-money security interests in personal consumer property, there is another important distinc-

tion between this case and *Radford*. In *Radford*, the Court stressed that the legislation at issue operated *only* retrospectively. 295 U.S. at 595. This provided not only strong evidence that the security interest was of substantial value,[9] but also indicated that the legislation was not merely a neutral revision of the bankruptcy laws with only incidental retrospective effect. Moreover, the property subject to the mortgage in *Radford* was not even exempt from inclusion in the bankrupt estate. 295 U.S. at 577. Here, by contrast, Section 522(f) is a neutral addition to the bankruptcy laws that operates both retrospectively and prospectively to safeguard statutory exemptions. The particular type of security interest involved lacks the substantial value to creditors of a mortgage. Accordingly, Congress had no concern that the limited provision of Section 522(f) would deter the extension of consumer credit or significantly interfere with debtor-creditor transactions in the future.

Section 522(f) embodies a carefully considered judgment by Congress, acting in the exercise of its plenary bankruptcy power, which is entitled to substantial deference by this Court. As a statute "adjusting the burdens and benefits of economic life," Section 522(f) is entitled to a strong presumption that it satisfies the requirements of the Fifth Amendment—both under the Due Process Clause (*Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976)) and under the Just Compensation Clause (*Penn*

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[9] Congress had fashioned this depression-era lien avoidance provision to apply only to pre-existing mortgages because of its fear that prospective application would prevent farmers from getting any mortgage financing in the future. 295 U.S. at 595-596 & n.27.

*Central Transportation Co.* v. *New York City*, 438 U.S. 104, 124 (1978)). See generally Note, *Lien Avoidance Under Section 522(f) of the Bankruptcy Code: Is Retrospective Application Constitutional*, 49 Fordham L. Rev. 615 (1981). Given the narrowness of Section 522(f) and its importance in safeguarding debtor exemptions, the court of appeals erred in extending *Radford* beyond its context to the facts of this case.

## CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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*Acting Solicitor General*

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JULY 1981

# Appendix

APPENDIX A

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

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APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO

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No. 80-1549

U.S. Bankruptcy No. 80-M-0014)

DONALD LEE RODROCK and JANEL CAROL RODROCK,
PLAINTIFFS-APPELLANTS,

*v.*

SECURITY INDUSTRIAL BANK, DEFENDANT-APPELLEE,

UNITED STATES OF AMERICA, INTERVENOR-APPELLANT.

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No. 80-1550

(U.S. Bankruptcy No. 80-M-0224)

PAMELA SUE KNEZEL, PLAINTIFF-APPELLANT,

*v.*

SECURITY INDUSTRIAL BANK, DEFENDANT-APPELLEE,

UNITED STATES OF AMERICA, INTERVENOR-APPELLANT.

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No. 80-1551

(U.S. Bankruptcy No. 80-K-0294)

ROSEMARY LOUISE HOOPS, PLAINTIFF-APPELLANT,

*v.*

FREEDOM FINANCE and SECURITY INDUSTRIAL BANK, DEFENDANTS-APPELLEES,

UNITED STATES OF AMERICA, INTERVENOR-APPELLANT.

No. 80-1552

(U.S. Bankruptcy No. 80-C-0178)

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NOVAL JAMES JACKSON and JERRIE (NMN) JACKSON, PLAINTIFFS-APPELLANTS,

*v.*

SECURITY INDUSTRIAL BANK, DEFENDANT-APPELLEE,

UNITED STATES OF AMERICA, INTERVENOR-APPELLANT.

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No. 80-1553

(U.S. Bankruptcy No. 80-Mc-0056)

PAUL LEROY STEVENS and SARA ANN STEVENS, PLAINTIFFS-APPELLANTS,

*v.*

LIBERTY LOAN CORPORATION, DEFENDANT-APPELLEE,

UNITED STATES OF AMERICA, INTERVENOR-APPELLANT.

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APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

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No. 80-2267

(U.S. Bankruptcy No. 79-11718)

IN RE: RANDALL DEAN SCHULTE and
OLLIE DENISE SCHULTE, a/k/a OLLIE DENISE DEHNE,
PLAINTIFFS-APPELLANTS,

*v.*

BENEFICIAL FINANCE OF KANSAS, INC.,
DEFENDANT-APPELLEE,

UNITED STATES OF AMERICA, INTERVENOR-APPELLANT.

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No. 80-2268

(U.S. Bankruptcy No. 79-11745)

IN RE: RICHARD GLEN HUNTER and
SHARON KAY HUNTER, PLAINTIFFS-APPELLANTS,

*v.*

BENEFICIAL FINANCE OF KANSAS, INC.,
DEFENDANT-APPELLEE,

UNITED STATES OF AMERICA, INTERVENOR-APPELLANT.

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NATIONAL CONSUMER FINANCE ASSOCIATION,
AMICUS CURIAE

[March 2, 1981]

Before SETH, Chief Judge, and MCWILLIAMS and DOYLE, Circuit Judges.

McWILLIAMS, Circuit Judge.

Each of these seven cases is a direct appeal to this Court from a judgment of a United States Bankruptcy Court, pursuant to the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 405(c)(1)(B), 92 Stat. 2685 (West Supp. 1979), concerning the lien avoidance provisions of the Reform Act. The Reform Act of 1978 was enacted by Congress on October 6, 1978, and signed into law by the President on November 6, 1978. The effective date of the Reform Act is October 1, 1979. Five of the seven cases, Nos. 80-1549, 80-1550, 80-1551, 80-1552 and 80-1553, are direct appeals from judgments entered in the United States Bankruptcy Court for the District of Colorado.[1] The remaining two, Nos. 80-2267 and 80-2268, are direct appeals from judgments entered in the United States Bankruptcy Court for the District of Kansas.[2] These seven direct appeals were consolidated for hearing in this Court, as each appeal involves consideration of the same provision of the Reform Act, namely 11 U.S.C. § 522(f)(2) (Supp. III 1979). The particular statute is set forth in its entirety as an appendix to this opinion.

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[1] Nos. 80-1549 and 80-1550 are Rodrock v. Security Industrial Bank, and Knezel v. Security Industrial Bank, respectively, reported at 3 B.R. 629 (West), and at 6 B.C.D. 267 (CRR) (D. Colo. 1980) (consolidated cases). No. 80-1551 is Hoops v. Freedom Finance and Security Industrial Bank, 6 B.C.D. 273 (CCR) (D. Colo. 1980). Nos. 80-1552 and 80-1553 are Jackson v. Security Industrial Bank, and Stevens v. Liberty Loan Corporation, respectively, reported at 4 B.R. 293 (West) (D. Colo. 1980) (consolidated cases).

[2] Nos. 80-2267 and 80-2268, Schulte v. Beneficial Finance of Kansas, Inc., and Hunter v. Beneficial Finance of Kansas, Inc., No. 79-11745 (D. Kan. Oct. 27, 1980) (consolidated cases), are as yet unreported.

In each of these seven cases, creditors acquired non-possessory, non-purchase money security interests in personal property (household furnishing and appliances) from the debtors *before* the Reform Act was signed into law by the President on November 6, 1978, and also *before* the Act was passed by Congress on October 6, 1978. In each case the debtor instituted bankruptcy proceedings *after* the October 1, 1979, effective date of the Reform Act. In each case the debtor, pursuant to Section 522(f)(2), claimed exemptions for the various items which served as collateral in security agreements previously entered into. The secured creditors objected to such claims for exemption. Accordingly, the debtor in each instance filed a complaint in the Bankruptcy Court against his secured creditor, seeking to avoid the creditor's non-possessory, non-purchase money security interest in accordance with the provisions of Section 522(f)(2). In each case, the creditor moved to dismiss the debtor's complaint for lien avoidance.

In the two Kansas cases, the bankruptcy judge held that Congress did *not* intend for Section 522(f)(2) to apply to security interests which came into being before the November 6, 1973, enactment date of the Reform Act and dismissed the debtors' complaints. The debtors now appeal.

In the five Colorado cases, the bankruptcy judges held that Congress *did* intend that in cases filed after October 1, 1979, Section 522(f)(2) would apply to security interests which came into being before the

November 6, 1978, enactment date of the Reform Act. The Colorado bankruptcy judges further held, however, that such retroactive application of the statute was unconstitutional. In each case the judge dismissed the debtor's complaint. Those debtors also appeal. To summarize, in both the Kansas and Colorado Bankruptcy Courts the secured creditors prevailed, but the basis for the respective holdings was not the same.

In all seven cases, after notice by the Bankruptcy Courts, pursuant to 28 U.S.C. § 2403(a) (1976), the United States intervened to argue in favor of the constitutionality of Section 522(f)(2). In this Court, the United States, in effect, represents the debtors. As we view these appeals, there are two issues to be resolved: first, whether Section 522 (f)(2) is to be applied retroactively; and, second, if so, whether such retroactive application, under the facts of these cases, would be constitutional.[3]

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[3] We note that the issues framed here, while they apparently have not been decided by any of the other Courts of Appeals, have been the subject of opinions of bankruptcy courts in several parts of the country. *See, e.g.*, Pierce v. Oklahoma Health Services Federal Credit Union, 4 B.R. 671 (West) (W.D. Okla. 1980), in which the court upheld the interest of a lien creditor against an attempt by the bankrupt to set aside the interest under Section 522(f)(2). *Id.* at 674. In *Pierce*, the security interest had been created prior to the time the Reform Act was signed into law.

In a recent decision of the Bankruptcy Court for the District of Utah, it was held that Section 522(f)(2) was constitutional and could be applied retroactively, even so as to avoid security interests created before the Bankruptcy Reform Act was enacted. Pillow v. Avco Financial Services, Nos. 80-0058, 80-0059, 80-0060 and 80-0061 (D. Utah Jan. 9, 1981) (consolidated cases).

In several other cases, bankruptcy courts have dealt with the situation in which a security interest was created between

*Retroactivity*

The effective date of the Reform Act was October 1, 1979. Pub. L. No. 95-598, § 402(a) 92 Stat. 2682 (West Supp. 1979). The Reform Act provided that as of October 1, 1979, the former Bankruptcy Act was repealed. Pub. L. No. 95-598, § 401(a), 92 Stat. 2682 (West Supp. 1979). The Reform Act further provided that a case commenced before October 1, 1979, would be governed by the old Bankruptcy Act, as opposed to the Reform Act, and that such proceedings should thereafter be conducted in accord with the Bankruptcy Act. Pub. L. No. 95-598, § 403, 92 Stat. 2683 (West Supp. 1979). Cases commenced after October 1, 1979, were to be conducted in accord with the Reform Act, the old Bankruptcy Act having been repealed as of October 1, 1979.

The precise issue is whether Congress intended for a substantive portion of the Reform Act, such as Section 522(f)(2), to apply to security interests which were vested prior to the effective date of the Reform Act. We think Congress had such an intent. Cases filed in bankruptcy court shortly after the Oc-

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the date the Reform Act was signed into law and the date it became effective. In most of these cases, the bankruptcy courts have found the interests to be voidable. *See, e.g.*, U.S. Life Credit Corp. v. Steinart, 4 B.R. 354 (West) (W.D. La. 1980); Hawley v. Avco Financial Services of Oregon, Inc., 4 B.R. 147 (West) (D. Ore. 1980); In re Beck, 4 B.R. 661 (West) (C.D. Ill. 1980); and Head v. Home Credit Co., 4 B.R. 521 (West) (D. Tenn. 1980).

Of course, none of the cases presented here involve a security interest which was created between the time the Act was signed into law and the time it became effective, since the security interests in these seven cases all were created prior to the date that the Reform Act was passed by Congress.

tober 1, 1979, effective date of the Reform Act would necessarily involve creditors' interests which came into being prior to the effective date of the Reform Act. As of October 1, 1979, the old Bankruptcy Act stood repealed. So, if, in a bankruptcy case filed on or after October 1, 1979, the Reform Act does not apply to creditors' interests which came into existence prior to October 1, 1979, then there would be *no* bankruptcy law governing the particular matter at hand. We cannot believe that Congress intended such a statutory "gap."

Stated somewhat differently, the issue is whether, with the old Bankruptcy Act repealed as of October 1, 1979, except for cases commenced prior to that date, the provisions of the Reform Act should be applied prospectively only. If the Reform Act were applied only to those cases commenced after October 1, 1979, which involved security interests which came into existence *after* that date, there would be *no* bankruptcy law applicable to cases filed after October 1, 1979, but involving security interests which were fixed prior to October 1, 1979. We cannot believe that Congress intended such a no-man's land. Based on such reasoning, we conclude that Congress intended for substantive provisions of the Reform Act, such as Section 522(f)(2), to be given retroactive effect to the end that such statutory provisions govern security interests that came into being before the effective date of the Reform Act.

Having determined that Section 522(f)(2) should be given retroactive effect, we find nothing in the Reform Act itself to indicate that Congress intended for the Reform Act to be given only a limited retroactive effect, *i.e.*, to a particular date, as, for example, November 6, 1978, the enactment date of the

Reform Act. The Reform Act is either to be retroactively applied, or to be applied only in a prospective manner. We believe it was Congress' intent to apply the Reform Act retroactively. Accordingly, we agree with the holding of the Colorado Bankruptcy Court that Congress intended the Reform Act to be retroactively applied to the creditors' interests here involved. We are not in accord with the ruling of the Kansas Bankruptcy Court that Congress did not intend such a retroactive application of Section 522(f)(2). The fact that we do not agree with the Kansas Bankruptcy Court on the retroactivity issue does not mean, however, that its judgment must be reversed. There remains the issue of whether the provisions of Section 522(f)(2) can be constitutionally applied to a creditor's security interest which vested *prior* to the enactment date of the Reform Act, *i.e.*, November 6, 1978.

*Constitutionality*

The Colorado Bankruptcy Court held that, under Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935), Section 522(f)(2) could not be constitutionally applied to a creditor's security interest which came into being prior to the enactment date of the Reform Act. We agree. *Radford* involved an amendment to the Bankruptcy Act which preserved to a defaulting mortgagor of farm property the ownership and enjoyment of his farm and took from the mortgagee rights in specific property held as security. The Supreme Court in *Radford*, speaking through Justice Louis D. Brandeis, declared the amendment to the Bankruptcy Act unconstitutional

under the Fifth Amendment.[4] In so doing, the Court recognized that, although Congress, under the bankruptcy power, may discharge a debtor's personal obligation, because, unlike the states, Congress is not prohibited from impairing the obligation of contract, nevertheless Congress could not take for the debtor's benefit rights in specific property acquired by a creditor prior to the amendment of the Bankruptcy Act. In the instant cases, the creditors acquired rights in specific property prior to the enactment of the Reform Act, and, under *Radford*, these vested rights cannot be taken from the creditor for the benefit of the debtor. It should be noted that, in the instant cases, there would be a complete taking of the secured creditors' property interests.

Counsel suggests that, with the passage of time, *Radford* has lost is steam and that later decisions of the Supreme Court cast doubt on the continuing vitality of that decision. We disagree.[5] Such cases

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[4] It should be noted that the situation involved in these seven cases is even more extreme than that presented in *Radford*. In these cases, the result argued for by the bankrupts would serve to totally deprive the secured creditors of any rights in the property. In comparison, in *Radford*, the bankruptcy provision involved would have permitted the mortgagee to realize some value from its mortgage interest. 295 U.S. at 575-76, 594-95.

[5] We note that, not only has *Radford* never been overruled, either expressly or impliedly, but it has continued to be cited by the Supreme Court. *See, e.g.*, Armstrong v. United States, 364 U.S. 40, 44 (1960).

Not only has the Supreme Court continued to cite *Radford*, but the case was cited by the Congress with approval in the Congressional Reports dealing with the Bankruptcy Reform Act. S. Rep. No. 95-989, 95th Cong., 2d Sess. 76, reprinted in [1978] U.S. Code Cong. & Ad. News 5768, 5862 (footnote

as Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke, 300 U.S. 440 (1937)[6] and Kuehner v. Irving Trust Co., 299 U.S. 445 (1937)[7] may well refine the rule of *Radford*, but they do not destroy the fundamental teachings of *Radford* that Congress may not under the bankruptcy power completely take for the benefit of a debtor rights in specific property previously acquired by a creditor.

Having concluded that Section 522(f)(2) cannot, under the Fifth Amendment, be applied to a creditor's security interest in specific property acquired prior to the enactment date of the Reform Act, we hereby affirm all judgments.

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omitted). H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 361, reprinted in [1978] U.S. Code Cong. & Ad. News 5963, 6317.

[6] In *Wright*, the Court upheld a law that merely postponed a mortgagee's right to foreclose on a mortgagor's property upon default. In effect, the *Wright* Court found that the law involved did not constitute a complete taking of the mortgagee's interest, but merely a postponement of the time at which the mortgagee could assert its rights. 300 U.S. at 456-62.

In comparison, the application of Section 522(f)(2) which is sought by these debtors would result in a complete deprivation of the secured creditors' vested property rights. Further, it is to be noted that the Supreme Court, in *Wright*, did not overrule *Radford*. In fact, *Radford* is cited with approval in *Wright*. 300 U.S. at 456-57.

[7] In *Kuehner*, the right involved was a contract right of a landlord under a lease. 299 U.S. at 447. The Court noted that there was a "significant difference between a property interest and a contract, since the Constitution does not forbid impairment of the obligation of the latter." *Id.* at 452. Again, the Court cited with approval its earlier decision in *Radford*. *Id.* at 450-52.

## APPENDIX

U.S. § 522(f). Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—

(1) a judicial lien; or

(2) a nonpossessory, nonpurchase-money security interest in any—

(A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(C) professionally prescribed health aids for the debtor or a dependent of the debtor.

*Note:* The federal exemptions as to the items above listed are as follows:

§ 522(d)(3) provides an exemption, not to exceed $200 in value, in any particular item listed in subsection (A) above, except for jewelry.

§ 522(d)(4) provides an exemption, not to exceed $500, in the aggregate value of jewelry.

§ 522(d)(6) provides an exemption, not to exceed $750, in the aggregate value of items used in a trade.

§ 522(d)(9) exempts, without qualification, prescribed medical items.

APPENDIX B

No. 80-1551

(U.S. Bankruptcy No. 80-K-0294)

ROSEMARY LOUISE HOOPS, DEBTOR-PLAINTIFF

*vs.*

FREEDOM FINANCE and SECURITY INDUSTRIAL BANK,
DEFENDANTS-APPELLEES,

DOLORES B. KOPEL, United States Trustee,
INTERVENOR-PLAINTIFF-APPELLANT.

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No. 80-1552

(U.S. Bankruptcy No. 80-C-0178)

NOVAL JAMES JACKSON and JERRIE (NMN) JACKSON,
DEBTORS-PLAINTIFFS,

*vs.*

SECURITY INDUSTRIAL BANK, DEFENDANT-APPELLEE,

DOLORES B. KOPEL, United States Trustee,
INTERVENOR-PLAINTIFF-APPELLANT.

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No. 80-1553

(U.S. Bankruptcy No. 80-Mc-0056)

PAUL LEROY STEVENS and SARA ANN STEVENS,
DEBTORS-PLAINTIFFS,

*vs.*

LIBERTY LOAN CORPORATION, DEFENDANT-APPELLEE,
DEFENDANT-APPELLEE,

DOLORES B. KOPEL, United States Trustee,
INTERVENOR-PLAINTIFF-APPELLANT.

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No. 80-2267

(U.S. Bankruptcy No. 79-11718 and 79-11745 Cons.)

RANDALL DEAN SCHULTE, OLLIE DENISE SCHULTE, a/k/a OLLIE DENISE DEHNE, RICHARD GLEN HUNTER, SHARON KAY HUNTER, DEBTORS-PLAINTIFFS,

*vs.*

BENEFICIAL FINANCE OF KANSAS, INC., DEFENDANT-APPELLEE,

DOLORES B. KOPEL, United States Trustee, INTERVENOR-APPELLANT.

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No. 80-2268

(U.S. Bankruptcy No. 79-11718 and 79-11745 Cons.)

RANDALL DEAN SCHULTE, OLLIE DENISE SCHULTE, a/k/a OLLIE DENISE DEHNE, RICHARD GLEN HUNTER, SHARON KAY HUNTER, DEBTORS-PLAINTIFFS,

*vs.*

BENEFICIAL FINANCE OF KANSAS, INC.,

DOLORES B. KOPEL, United States Trustee, INTERVENOR-APPELLANT.

[March 2, 1981]

These causes came on to be heard on the records on appeal from the United States Bankruptcy Court for the District of Colorado as to 80-1549, 80-1550, 80-1551, 80-1552, and 80-1553; and on the records on appeal from the United States Bankruptcy Court for the District of Kansas as to 80-2267 and 80-2268; and were consolidated for hearing and were argued by counsel.

Upon consideration whereof, it is ordered that the judgments of the United States Bankruptcy Court for the District of Colorado as to appeals Nos. 80-1549, 80-1550, 80-1551, 80-1552, and 80-1553 are affirmed.

It is further ordered that the judgments of the United States Bankrutcy Court for the District of Kansas as to appeals Nos. 80-2267 and 80-2268 are affirmed.

/s/ Howard K. Phillips
HOWARD K. PHILLIPS
Clerk

APPENDIX C

# UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF COLORADO

Proceeding Number 80 M 0014

IN RE DONALD LEE RODROCK and
JANET CAROL RODROCK, DEBTORS/PLAINTIFFS,

*vs.*

SECURITY INDUSTRIAL BANK, DEFENDANT.

and

Proceeding Number 80 M 0224

IN RE PAMELA SUE KNEZEL, DEBTOR/PLAINTIFF,

*vs.*

SECURITY NATIONAL INDUSTRIAL BANK, DEFENDANT.

## MEMORANDUM OPINION

These two cases have been combined for disposition because they present an identical question. Both arise from complaints filed pursuant to 11 U.S.C. 522(f) to void liens created prior to November 6, 1978 by nonpossessory, nonpurchase-money security interests in personal property of the Plaintiffs who are Chapter 13 debtors. A defense has been interposed which questions the constitutionality of the statute if applied to the Defendant. It is asserted that the avoidance of the Defendant's liens would result in the deprivation of a valuable and substantive property right without due process of law as mandated by the Fifth Amendment.[1]

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[1] After notice to the Attorney General of the constitutional issue, the Government has been permitted to intervene only as to the question of law presented.

In both cases, the subject security interests were created prior to November 6, 1978. If the Plaintiffs succeed, these interests would be of no value, and the Defendant would be dealt with as a creditor holding an unsecured claim. Owing to the treatment of unsecured claims provided in both plans, the Defendant would receive one dollar in each case.[2]

The statute with which we deal is part of the overall provision creating exemption rights in debtors' property. The remedy provided by § 522(f) is the avoidance of liens which encumber exemptions in specific property. In pertinent part, it reads:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—
>
> * * * * *
>
> (2) a nonpossessory, nonpurchase-money security interest in any—

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[2] The evidence taken by the Court at the hearings on confirmation held concurrently with hearings on the subject complaints includes a stipulation between the Plaintiffs and the Defendant of the value of the property subject to the liens in question. In the Rodrock case, it was agreed that collateral consisting of 15 items of household furnishings, including a color television set and a sewing machine with table, are worth $580.00. In the Knezel case, it was stipulated that the Debtor's furniture, kitchenware, a sewing machine, and a movie projector are worth $540.00. It is not stipulated whether the values represent liquidation value, market value, or replacement value, but as it was agreed between the parties, the basis of the valuation was of no consequence to the Court. In each case, the collateral for the subject loans represents every household item owned by the Debtors.

(A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

* * * * *

The issue raised by the Defendant is that application of this subsection to secured loans made and perfected prior to the date of adoption of the Bankruptcy Reform Act of 1978, November 6, 1978, constitutes a deprivation of the Defendant's security interest without due process of law. In support, the Defendant relies almost exclusively upon *Louisville Joint Stock Bank* v. *Radford*, 295 U.S. 555 (1935).

Speaking for the opposition with consent of Plaintiffs counsel, the Government argues that *Radford* has been "enervated" by subsequent decisions, and hence is no longer precedent for the case at hand. In addition, it is contended that acting within the bankruptcy power created by Article 1, section 8(4) of the Constitution, Congress has the power to impair vested rights in property. The Government also postulates that only the deprivation of *substantial* rights is subject to invalidity on constitutional grounds, and it is contended that the lien rights in question here are not substantial. In my judgment, while these contentions are initially appealing, a careful analysis proves them to be without substance.

Is it true that *Radford*, *supra*, has been abandoned or so eroded that it is without vitality? In order to answer that question, one must first understand the principle for which *Radford* stands. In that case, the Supreme Court had before it the question of the constitutionality of the Frazier-Lempke Act of 1933

which amended § 75 of the Bankruptcy Act. Enactment of Frazier-Lemke was prompted by the Great Depression, and it was intended to bring relief to beleaguered farmers by providing them with a means for saving the family farm from foreclosure. As originally passed, Frazier-Lemke would have permitted a debtor to obtain a five-year stay of state foreclosure proceedings from a court of bankruptcy. Meanwhile, the debtor would retain possession of his property under court supervision, subject to the payment of a reasonable rent. At the end of the period of that stay, the debtor would pay into the court an appraised price (subject to judicial determination) and thereafter obtain the property free and clear of the original indebtedness. Although the creditor would receive the benefit of the rents and the appraised price, the creditor would lose any of the rights and remedies that had been available to him under the terms of his mortgage.

Pointing out that Frazier-Lemke was the first instance in which any legislative body attempted to compel a mortgagee to relinquish a lien without full payment of the underlying debt, and observing such a statute was foreign to any bankruptcy law precedent, the Court stated:

> The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the states, it is not prohibited from impairing the obligations of contracts. (Cita.) But the effect of the act here complained of is not the discharge of Radford's personal obligation. It is the taking of *substantive rights in specific property acquired by the bank*

*prior to the act.* (emphasis added) (295 U.S. at 589)

The Court continued that the secured creditor was entitled to certain rights in the specific property held as collateral, including the right to retain a lien until the indebtedness is paid in full. Additionally, under the law of the state in which the action arose, secured creditors were also deprived of other incidental mortgage rights by Frazier-Lemke.[8] The Court then concluded:

> The province of the Court is limited to deciding whether the Frazier-Lemke Act (Cita.) as applied has taken from the bank without compensation, and given to Radford, rights in specific property which are of substantial value. * * * As we conclude that the act as applied has done so, we must hold it void; for the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken even for wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public. (295 U.S. at 602)

In my judgment then, *Radford* stands for the proposition that a substantive right in specific prop-

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[8] These were the right to realize upon the security at a judicial sale; the right to determine, subject to the discretion of a court, when the sale would be held; the right to protect the creditor's interest by bidding at the sale; and the right to control the property during the period of the default.

erty cannot be substantially impaired by legislation enacted after the right has been created without doing violence to the property owner's right to due process. In this context, it is clear that a secured creditor's rights are substantial.

The Government has sought to distinguish *Radford* on the grounds that the creditor's right therein was a right in real property and therefore more substantial than the rights of a creditor whose only security is in personal property. Yet, as much as the Government would like it, such a distinction does not exist. Any lien is a matter of property and not a mere matter of procedure *Sager* v. *Burgess*, 350 F. Supp. 1310 (D. Pa. 1972); aff'd 411 U.S. 941 (1973); *In re Pennsylvania Central Brewing Co.*, 35 F. 2d 60 (3rd Cir., 1943); *Britton* v. *Western Iowa Co.*, 9 F. 2d 488 (8th Cir. 1925). Moreover, for constitutional purposes, it makes no difference whether liens are on personal property or real property. Cf. *Armstrong* v. *United States*, 364 U.S. 40 (1960); *Ginsberg* v. *Lindel*, 107 F. Supp. 721 (8th Cir. 1939). Accordingly, the case must turn on whether *Radford* has been eroded as the Government insists.

Although it is not contended otherwise, it should still be noted that *Radford* has not been directly overruled. Thus, one can reach the Government's position only through analogy.[4] After consideration, I find that the cases upon which the Government relies do no harm at all to the *Radford* principle.

In *Wright* v. *Vinton Branch of the Mountain Trust Bank of Roanoke*, 300 U.S. 440 (1937), the Court

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[4] It is also noteworthy that the cases which the Government argues enervate *Radford* are characterized by the Defendant as "refinements".

had occasion to uphold a post-*Radford* amendment to the Fraizer-Lemke Act. In the redraft of the Act, Congress preserved three of the rights enumerated by the Court in *Radford* as essential to the interest of the secured creditor. In reaching its conclusion that the Frazier-Lemke Act did not conflict with the Fifth Amendment, the Court observed:

> The question * * * is not whether the Act does more than modify remedial rights. It is whether the legislation modifies the secured creditor's rights, remedial or substantive, to such an extent as to deny the due process of law guaranteed by the Fifth Amendment. (300 U.S. at 470)

While the Government argues that *Vinton Branch* represents a departure from *Radford*, I find it quite to the contrary. The fact remains that in its redraft of Frazier-Lemke, Congress reserved to secured creditors the right to retain liens until full satisfaction of the underlying obligation. In addition, the new version also returned to the creditors the right to satisfaction of the debt from the secured property. These are perhaps the quintessential rights of any secured creditor, and to say, therefore, that *Vinton Branch* represents an erosion of *Radford* is to disregard the significance of the rights available to secured creditors following the Fraizer-Lemke amendment.

It is urged that *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445 (1937), represents a "step in the flight away from *Radford*." In *Kuehner*, the Court upheld the provision of § 77B(b) of the Bankruptcy Act then in force which limited a landlord's indemnification for loss of future rents. While the Government argues that the case illustrates that a creditor's

right may be impinged, it is manifestly clear that the right affected was not a substantive right in specific property, but a contractual right which *can* be affected by exercise of the bankruptcy power. Indeed, the Court said:

> [T]here is, as respects the exertion of the bankruptcy power, a significant difference between a property interest and a contract since the Constitution does not forbid impairment of the obligation of the latter * * *. While * * * the Fifth Amendment forbids the destruction of a contract it does not prohibit bankruptcy legislation affecting the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, if the statutory provisions are consonant with a fair, reasonable, and equitable distribution of those assets. (299 U.S. at 451)

In *Wright* v. *Union Central Life Ins. Co.*, 311 U.S. 273 (1940), the Court did refine its *Radford* rule by allowing a debtor to redeem mortgaged property at an appraised value instead of by full payment of the indebtedness. This departure, such as it may be, still leaves intact the rule that liens may not be entirely destroyed. The Court stated:

> Safeguards were provided to protect the rights of secured creditors, through the proceedings, to the extent of the value of the property. * * * There is no constitutional claim of the creditor to more than that. (311 U.S. at 278)

From my reading of these cases, I have concluded that although *Radford* may be old, it is far from dead. Indeed, it stands as a venerable and vigorous sentinel of due process rights. Since the *Radford*

principle is so clearly grounded upon the due process clause of the Fifth Amendment, other authorities relied upon by the Government dealing strictly with physical expropriation or the compensated taking of property are simply inapposite and not worthy of further discussion.

As I view this case, the constitutional difficulty § 522(f) presents is the means chosen by Congress for achieving a laudable purpose. It seems evident that legislation which effects the total deprivation of a substantive right in specific property antedating the statute is unreasonable. Although it appears Congress had a substantial motivation for the enactment of § 522(f)[5], and while the purported goal seems proper in light of the "fresh start" objectives of the bankruptcy law, I firmly believe that *Radford* teaches us that such an objective cannot be achieved at the

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[5] Legislative history indicates:

> Frequently, creditors lending money to a consumer debtor take a security interest in all of the debtor's belongings, and obtain a waiver by the debtor of his exemptions. In most of these cases, the debtor is unaware of the consequences of the form he signs. The creditor's experience provides him with a substantial advantage. If the debtor encounters financial difficulty, creditors often use threats of repossession of all of the debtor's household goods as a means of obtaining payment.
>
> In fact, were the creditor to carry through on his threat and foreclose on the property, he would receive little, for household goods have little resale value. They are far more valuable to the creditor in the debtor's hands for they provide a credible basis for the threat, because the replacement costs of the goods are generally high. Thus, creditors rarely repossess, and debtors ignorant of the creditor's true intentions, are coerced into payments they simply cannot afford to make. H.R. Rep. No. 95-595 at p. 127.

expense of creditors whose rights in specific property have attached prior to the enactment of the law.[6]

Though the intrinsic value of each item of collateral may be low, it cannot be overlooked that those items are still valuable. I cannot believe that the retrospective destruction of those rights in such property can be constitutionally sanctioned simply because they have little intrinsic worth. It is the right to hold that property which is protected by the Fifth Amendment, and the exercise of that right is not a function of its value in dollars.

Two remaining issues demand brief discussion in order to afford complete exposition of this case. First, in order to remove any lingering doubt which may be occasioned by my treatment of this matter, I am cognizant of the fact that any Court should be wary of finding statutes in conflict with the Constitution. If there is a ground upon which an enactment can be sustained so that a constitutional issue can be avoided, that is the ground upon which a Court should rest. *Bowen* v. *United States*, 442 U.S. 916 (1975); *Wright* v. *Vinton Branch of Mtn. Trust Bank, supra.* Yet, in this case, as hard as I looked, I could find no basis upon which application of § 522 (f) to security agreements made and perfected prior to November 6, 1978 could be sustained.[7]

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[6] It is not without reason to suspect that Congress recognized the verity of this statement in its adoption of 11 U.S.C. 1325(a)(5)(B). That subsection of Chapter 13 allows a debtor to retain possession of secured property against the will of the creditor, but as a price for that privilege the law allows the secured creditor to retain his lien and be paid the full value of the collateral. In this instance, the statute provides both a response to the debtor's needs and a reasonable means for its achievement.

[7] Whether the same results would apply to agreements made after that date is not decided here.

Second, it has been suggested that since there is nothing within the parameters of the Bankruptcy Reform Act of 1978 which specifically makes § 522 (f) applicable to agreements entered into before November 6, 1978, the Court should find the statute was intended to work prospectively only. See: *Edgar* v. *Fred Jones Lincoln Mercury*, 524 F. 2d 162 (10th Cir. 1975). That suggestion does not comport with the overall scheme of the Act as a whole, however. I believe it clear that Congress intended retrospective application of the Act, for it stated:

> A case commenced under the Bankruptcy Act, and all matters and proceedings in or relating to any such case, shall be conducted and determined under such Act as if this Act had not been enacted, and the substantive rights of parties in connection with any such bankruptcy case, matter, or proceeding shall continue to be governed by the law applicable to such case, matter, or proceeding as if the Act had not been enacted. § 403, Pub. L. 95-598, Title IV, Nov. 6, 1978, 92 Stat. 2683.

Thus, only cases commenced prior to the effective date of the Bankruptcy Reform Act of 1978 are to be determined according to the former Bankruptcy Act. In other respects, for our purposes here, the former Bankruptcy Act has been repealed. § 401, Title IV, Pub. L. 95-598.

It would thus seem apparent that if, in cases filed after October 1, 1979, Congress did not intend the substantive provisions of the Bankruptcy Reform Act to apply to obligations created prior to November 6, 1978, there would be no bankruptcy laws in effect to deal with those debts. Since it cannot

be seriously suggested that such was the legislative intent, one must conclude that retrospective application was clearly intended.

Having determined that the application of 11 U.S.C. 522(f) to the Defendant in this case would be to deny it substantive due process, the final resolution of this case is clear. The complaints will be dismissed with an appropriate order.

DATED: April 25, 1980

BY THE COURT:

/s/ John P. Moore
JOHN P. MOORE
Bankruptcy Judge

## APPENDIX D

# UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF COLORADO

No. 80 K 0294

IN RE ROSEMARY LOUISE HOOPS, DEBTOR,
ROSEMARY LOUISE HOOPS, PLAINTIFF,

*vs.*

FREEDOM FINANCE and
SECURITY INDUSTRIAL BANK, DEFENDANTS.

## MEMORANDUM OPINION UPON DEFENDANT'S MOTION TO DISMISS

GLEN E. KELLER, JR., Bankruptcy Judge

Plaintiff seeks by her complaint to invoke the provisions of 11 U.S.C. § 522(f)[1] and avoid the fixing

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[1] (f) Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—

(1) a judicial lien; or

(2) a nonpossessory, nonpurchase-money security interest in any—

(A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(C) professionally prescribed health aids for the debtor or a dependent of the debtor.

of a lien upon her household goods to the extent that such lien impairs the exemptions granted pursuant to 11 U.S.C. § 522(d). Admitting that it holds a nonpossessory, nonpurchase-money security interest in household goods granted in an agreement dated prior to November 6, 1978, the date of enactment of the Bankruptcy Reform Act of 1978 (Pub. L. 95-598), Defendant Security Industrial Bank seeks dismissal of the complaint. The Defendant asserts that the statute cannot be constitutionally applied to avoid its otherwise admittedly valid security interest [2] under the proscriptions of the Fifth Amendment. After notice pursuant to 28 U.S.C. § 2403 and Rule 20, Local Rules of Bankruptcy Procedure, the United States has intervened to argue in favor of the constitutionality of the statute as sought to be applied in this case.

The merits squarely depend on the continuing vitality of *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 (1935). The Defendant reads *Radford* as being based on the clause of the Fifth Amendment prohibiting the taking of private property for public use without just compensation. However, *Radford*, particularly as subsequently construed by the Supreme Court, appears to rest on substantive due process grounds.[3] In the case at bar, it is doubtful that the government has taken anything for public use as any lien will inure solely to the private benefit of the

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[2] The United States takes no position here as to the validity under applicable law of the Defendant's security interests but assumes it *arguendo*.

[3] *Wright* v. *Vinton Branch of Mountain Trust Bank*, 300 U.S. 440 (1957) at 457, *Wright* v. *Union Central Ins. Co.*, 304 U.S. 502 (1938) n.23 at 517.

debtor. Had the government exercised its eminent domain power to purchase the liens held by the Defendant and then transferred the liens to the Debtor, this Court would be obliged to respect the congressional determination of public benefit. *Cf. Berman* v. *Parker*, 348 U.S. 26, 75 S. Ct. 98, 99 L. Ed. 27 (1954). Here, however, the government has merely allowed individual debtors, at their option, to avoid certain creditors' liens. If a taking has occurred, it has been by the Debtor for a private use, not by the government for a public use.

It must be conceded that the boundaries of the taking and due process clauses are not always well marked as *Radford* itself indicates. Under either clause, the substantive issue before the Court involves weighing the strength of the public interest against the nature and extent of the impairment of the private interest involved. The Court's preference for proceeding under the due process clause is largely historical. It is generally considered to be the only restraint on federal retroactive legislation. See C. Hockman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692 (1960).

Preliminarily, it must be decided whether § 522 (f) would operate retroactively if applied to security interests which predated its enactment. A substantial body of case law has developed supporting the proposition that legislation is presumed to operate prospectively only.[4] See, *e.g.*, *Claridge Apartments Co.* v. *United States*, 323 U.S. 141, 65 S. Ct. 172,

[4] Concededly, courts should interpret legislative pronouncements to avoid constitutional questions. Prospective application would accomplish the avoidance here but raises substantially greater questions.

89 L. Ed. 139 (1944); *Gibbons* v. *Pan American Petroleum Corp.*, 262 F.2d 852 (10th Cir. 1958). Retroactive statutes have been defined as those which take away or impair rights acquired under prior law or which create new disabilities with respect to past transactions. *Lohf* v. *Casey*, 330 F. Supp. 356 (D.C. Colo. 1971), *aff'd.* 466 F.2d 618 (10th Cir. 1972). However, the appellate opinion also indicates that a statute is not retroactive merely because it acts upon facts or rights established prior to its passage. Applying these maxims in concrete cases can generate considerable confusion because of the inherent elusiveness of the concept of retroactivity.[5] Here the United States has argued that § 522(f) would not operate retroactively if applied to pre-enactment security interests because it simply acts prospectively on previously acquired security interests. This contention turns retroactively into a play on words. If § 522 (f) were expressly made effective as of January 1, 1970, no one could dispute its retroactivity. The practical effect of the statute so worded would be identical to the statute here if the Plaintiff's construction is correct. *Radford* considered the Frazier-Lemke Act retroactive because it applied to secured debts created before its passage. No case has been cited to or found by the Court which holds that a statute which authorizes the avoidance of pre-enactment security interests operates prospectively only.

There remains the issue of whether § 522(f) should be construed to avoid retroactive application and, thus, the constitutional problem. The construc-

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[5] See W. Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 Cal. L. Rev. 216 (1960). Note also the differences in the trial court and appellate opinions in *Lohf* v. *Casey* cited in the text.

tional preference for prospectivity may obviously be overridden by a contrary legislative intent. Title I of Pub. L. 95-598 was effective October 1, 1979 (§ 402). The savings provisions (§ 403) make clear that the provisions of the new Code were to govern in all proceedings initiated on and after that date without reference to when the creditors' claims arose. Proceedings initiated before that date were to be governed in all substantive aspects by the Bankruptcy Act. Simply put, the date of the filing of the petition controls which law applies. *Cf. Holt* v. *Henley*, 232 U.S. 637, 34 S. Ct. 459, 58 L. Ed. 767 (1914). A different result was not intended by Congress. Bankruptcy statutes have traditionally operated retroactively in the sense that they apply to secured claims and creditors' interests which antedate their enactment. See, *e.g.*, *Wright* v. *Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 57 S. Ct. 556, 81 L. Ed. 736 (1937), *Claridge Apartments Co.* v. *United States*, *supra*; *Campbell* v. *Alleghany Corp.*, 75 F.2d 947 (4th Cir. 1935). Absent retroactive application and considering the repeal of the Bankruptcy Act, it is arguable that certain creditors of a debtor under the Code have interests not subject to the bankruptcy statutes. Accordingly, this Court concludes that § 522(f) was intended to apply to pre-enactment secured claims.

The constitutional issue must now be squarely faced: Does § 522(f) as applied to security interests created prior to November 6, 1978, violate substantive due process?

*Radford* found that the Frazier-Lemke Act[6] was inconsistent with the Federal Constitution. This was depression-spawned legislation designed to prevent

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[6] 48 Stat. 1289 (June 28, 1934).

foreclosure of farm mortgages by staying such proceedings during a five-year period in which the mortgagor was permitted to remain in possession while paying a fair annual rental which was disbursed among secured and unsecured creditors. At the end of the five-year period, the mortgage could be cancelled by the payment of the appraised price at the beginning of the period or at the end at the option of the mortgagee. The act specifically applied only to mortgages existing at the effective date of the act. Conceding that the power over property interests created after the effective date of the act might be greater than that over preexisting interests, the Court observed at 589:

> The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the states, it is not prohibited from impairing the obligations of contracts. Compare Mitchell v. Cark, 110 U.S. 633, 643, 4 S. Ct. 170, 312, 28 L. Ed. 279. But the effect of the act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the bank prior to the act. In order to determine whether rights of that nature have been taken, we must ascertain what the mortgagee's rights were before the passage of the act.

and, further, at 594:

> The controlling purpose of the act is to preserve to the mortgagor the ownership and enjoyment of the farm property. It does not seek

primarily a discharge of all personal obligations; a function with which alone bankruptcy acts have heretofore dealt. Nor does it make provision of that nature by prohibiting, limiting, or postponing deficiency judgments, as do some state laws. Its avowed object is to take from the mortgagee rights in the specific property held as security; and to that end "to scale down the indebteness" to the present value of the property. As here applied it has taken from the Bank the following property rights recognized by the law of Kentucky:

(1) The right to retain the lien until the indebteness thereby secured is paid.

(2) The right to realize upon the security by a judicial public sale.

(3) The right to determine when such sale shall be held, subject only to the discretion of the court.

(4) The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.

(5) The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt.

Two years later, in *Wright* v. *Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 57 S. Ct. 556, 81 L. Ed. 736 (1937), the Supreme Court sustained the amended Frazier-Lemke Act, which affected the

rights of mortgagees but not as substantially. *Vinton Branch* did not overrule *Radford* but limited and clarified its holding. The continued viability of *Radford* in determining the proper balance to be struck between the impairment of preexisting security interests and the bankruptcy power is not as important as is its clear holding that the bankruptcy power is subject to the constraints of the Fifth Amendment.[7] This is so because § 522(f) does not merely affect secured claims but authorizes their complete extinction.

The Supreme Court has often sustained state or local police power regulation that substantially affects the value of private property. See, *e.g.*, *Euclid* v. *Ambler Realty Corp.*, 272 U.S. 365, 47 S. Ct. 114, 71 L. Ed. 303 (1926); *Goldblatt* v. *Town of Hempstead*, 369 U.S. 590, 82 S. Ct. 987, 8 L. Ed. 2d 130 (1962). Section 522(f), however, is rooted in the bankruptcy power, particularly because Congress has no general police power. Thus, the police power cases offer no support for § 522(f) in this case. They do, however, recognize that government regulation can be so onerous to violate the Fifth Amendment. *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393, 43 S. Ct. 158, 67 L. Ed. 322 (1922). No burden could be more onerous than complete destruction of a property interest, but even that does not inevitably violate the Fifth Amendment. In *United States* v. *Caltex, Inc.*, 344 U.S. 149 (1952), the Supreme Court refused to require the government to compensate a property owner whose oil facilities were destroyed in advance of the Japanese invasion of the Philippines. Similarly, in *United States* v. *Central Eureka Mining Co.*,

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[7] *Vinton Branch* explicitly endorses *Radford* on this point at 456-457.

357 U.S. 155 (1958), a forced closure of a nonessential gold mine during World War II did not require compensation. Emergency situations which enable the government to destroy private property with impunity are not necessarily limited to wartime. *Miller* v. *Schoene*, 276 U.S. 272 (1928), involved destruction by the State of Virginia of infested ornamental trees which posed a serious threat to the state's apple industry. Again, it was held that no compensation was required by the Fifth Amendment. The United States argues that creditors' coercive use of threatened foreclosure on household goods and other necessaries to obtain postbankruptcy reaffirmation of the debt creates such an emergency as will justify complete retroactive application of § 522(f). This Court cannot in fairness place the evil sought to be remedied by § 522(f) in the same class as protection of public health or allocation of national resources in wartime. Even in *Vinton Branch*, the Court failed to use the great depression to support an emergency impairment of secured creditors' rights which was otherwise unconstitutional. Mr. Justice Brandeis said at 460: "Whether, in view of the emergency, an absolute stay of three years would have been justified under the bankruptcy power, we have no occasion to decide."

It has been strenuously argued that a lien on household goods is not a "substantial" right within the meaning of *Radford*, and, therefore, that its avoidance cannot violate due process. It is urged that *Radford* involved liens on real property, and § 522 (f) affects only liens on personal property. The Court finds no authority for the proposition that the Constitution offers greater protection to mortgages on realty than to other security interests. In-

deed, in *Armstrong* v. *United States*, 364 U.S. 40, 80 S. Ct. 1563, 4 L. Ed. 2d 1554 (1960), the Supreme Court cited *Radford* for the proposition that a lien is a compensable property interest under the Fifth Amendment. The lien taken in *Armstrong* was a mechanic's lien on a ship's hull, clearly personal property, whereas *Radford* involved real estate mortgages. The Supreme Court could find no distinction at 44:

> No reason has been suggested why the nature of the liens held by petitioners should be regarded as any different, for this purpose, from the interest of the bank held compensable in the *Radford* case.

It is also contended that liens on household goods are of insufficient value (ignoring their coercive effect) to be substantial for purposes of the Fifth Amendment. While the real estate mortgages in *Radford* may have been more valuable than *most* liens on household goods, the liens in *Radford* were not extinguished. Certain incidents of the liens relating to enforcement were impaired. Moreover, § 522(f) may not merely avoid liens on household goods to the extent of $200.00 per item, as might be indicated by § 522(d)(3). An additional exemption with a dollar ceiling of $7,900.00 for each debtor is available to be applied to any property under 11 U.S.C. § 522(d)(5). It appears that this total taken with the $200.00 per item exemption on household goods and the exemption for tools of trade can easily be equated with "substantial value" within the *Radford* holding.

On a more fundamental level, however, the Court recoils from the notion that dollar value is the meas-

ure of due process. A lien is a substantive property right for purposes of the Fifth Amendment. See *United States* v. *Armstrong, supra*; *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445 (1937). If the government destroys it in other than an emergency situation, it violates due process whether the collateral is worth $5 or $5 million.

Much argument has been made here that the past abusive uses of liens on household goods justifies a less stringent due process. However, the moral blameworthiness of legal conduct has never been thought to justify the retroactive imposition of liability with respect to such conduct. See *e.g.*, *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 96 S. Ct. 2882, 49 L. Ed. 752 (1976). When the government authorizes the destruction of private property, without expressly condemning it, the availability of milder remedies to accomplish the governmental purpose should be taken into account. If the purpose of § 522(f) is to stop the coercive use of liens on household goods in bankruptcy, the Code contains other means to fulfill it. Section 506(a) provides that a claim is secured only to the extent of the value of the collateral. Section 722 provides that a Chapter 7 debtor can redeem exempt household goods from a lien securing a dischargeable consumer debt by paying the creditor the allowed amount of the secured claim. If a debtor is unable to pay the secured claim in a lump sum, he may elect to seek relief under Chapter 13, where deferred payments may be permissible. See § 1325 (a)(5)(B). In any event, this limited restriction of the application of § 522(f) will not seriously impair the function of the section.

This Court does not lightly conclude that § 522(f), as applied to security interests created prior to its

enactment, violates due process. The power of Congress to establish "uniform laws on the subject of bankruptcies throughout the United States" is broad and evolving. As stated in *Wright* v. *Union Central Life Insurance Co.*, 304 U.S. 502, 513, 58 S. Ct. 1025, 82 L. Ed. 1490 (1938):

> The subject of bankruptcies is incapable of final definition. The concept changes. It has been recognized that it is not limited to the connotation in England or the States, at the time of the formulation of the Constitution.

But *Radford* holds that the bankruptcy power is subject to the constraints of due process. Due process itself changes, but it has never and will never allow the retroactive extinguishment of valid liens absent the direst of circumstances. As stated in another context by Mr. Justice Holmes in *Pennsylvania Coal Co.* v. *Mahon*, *supra*, at 413:

> Government could hardly go on if to some extent values incident to property could not be diminished without paying for every such change in the general law. As long recognized some values are enjoyed under an implied limitation and must yield to the police power. But obviously the implied limitation must have its limits or the contract and due process clauses are gone.

The due process clause should never be used as the instrument of imposing judicial notions of proper policy on the legislative branch. Neither should the judiciary abandon its role in our system. See *Moore* v. *City of East Cleveland*, 431 U.S. 494, 97 S. Ct. 1932, 52 L. Ed. 531 (1977). Section 522(f), as applied to preenactment security interests, simply goes

too far. The Defendant's motion to dismiss will be granted.

DONE at Denver in said District this 25th day of April, 1980.

BY THE COURT:

/s/ Glen E. Keller, Jr.
GLEN E. KELLER, JR.
United States Bankruptcy Judge

APPENDIX E

UNITED STATES DISTRICT COURT
D. COLORADO

Bankruptcy Nos. 80 C 0178, 80 Mc 0056

IN RE NOVAL JAMES JACKSON and
JERRIE (NMN) JACKSON, DEBTORS.

NOVAL JAMES JACKSON and
JERRIE (NMN) JACKSON, PLAINTIFFS,

*v.*

SECURITY INDUSTRIAL BANK, DEFENDANT.

IN RE PAUL LEROY STEVENS and
SARA ANN STEVENS, DEBTORS.

PAUL LEROY STEVENS and
SARA ANN STEVENS, PLAINTIFFS,

*v.*

LIBERTY LOAN CORPORATION, DEFENDANT.

May 19, 1980

Before JOHN F. MCGRATH and PATRICIA ANN CLARK, Bankruptcy Judges.

FINDINGS, CONCLUSIONS AND ORDER
UPON THE DEFENDANTS' MOTION
TO DISMISS

The matters before the Court are the defendants' motions to dismiss the plaintiffs' complaints to void

their liens in certain items of household goods under 11 U.S.C. 522(f). The defendants contend that an application of Section 522(f) to their security interest would deprive them of a substantive property right in violation of the due process clause of the Fifth Amendment. Since the issue presented in each case is identical, the cases have been combined for disposition.

The facts are as follows: Prior to November 6, 1978 the plaintiffs (Debtors herein) in each case obtained a loan from the defendants (Creditors herein) and granted them a seniority interest in certain items of household goods as collateral for such loan. No item of collateral exceeded $200.00 in value. On November 6, 1978 the President signed the Bankruptcy Reform Act of 1978 (P.L. 95 598, 92 Stat. 2549), Title I of which codified and enacted the new Bankruptcy Code. Section 402(a) of the Reform Act (P.L. 95-598 § 402(a)) provides: "[T]his Act shall take effect on October 1, 1979."

Subsequent to the effective date of the Reform Act, each of the Debtors filed a petition under Chapter 13 seeking an adjustment of their debts. They also filed a complaint under Section 522(f) to avoid the defendants' nonpossessory, nonpurchase-money security interest in their household goods otherwise exempt. If the Debtors are successful in avoiding the liens, the defendants would be relegated to the status of unsecured creditors entitled to receive one dollar under the Debtors' Chapter 13 Plans. Section 522(f) which the plaintiffs seek to utilize to avoid the defendants' liens provides in part:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an in-

terest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—

> (2) a nonpossessory, nonpurchase-money security interest in any—
>
> (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

The defendants contend that the Fifth Amendment to the Constitution precludes the retroactive application of Section 522(f) to void their security interests in the Debtors' household goods. The defendants claim that prior to enactment of the Reform act on November 6, 1978 they had acquired substantive rights in specific property of the Debtors pursuant to C.R.S. 1973, § 4-9-101 *et seq.*, the Colorado Uniform Commercial Code, Secured Transactions. The defendants contend that their lien rights are vested property rights which may not be taken under the later enacted Section 522(f) of the Code without just compensation. The intervenor United States contends that voiding the defendants' liens would not deprive them of substantial and substantive rights in violation of the Fifth Amendment. The Government argues that any alteration of the bank's contract rights pursuant to Section 522(f) is a valid exercise of Congressional power under the Bankruptcy Clause of the Constitution and does not constitute an unconstitutional taking. Finally, the government claims that the Code's history requires Section 522(f) to be applied retroactively.

It is clear that Congress intended the Reform Act to be applied to liens created before November 6, 1978, in cases filed on or after October 1, 1979. The former Bankruptcy Act has been repealed except for cases commenced prior to October 1, 1979 (P.L. 95-598, Title IV, § 403, 92 Stat. 2683). A refusal to apply provisions of the Reform Act to cases commenced after October 1, 1979 would result in a hiatus in the bankruptcy laws. The retroactive application of the Reform Act was discussed in the cases of *Rodrock* v. *Security Industrial Bank*, 3 B.R. 629, No. 80 M 0014 (D.Colo.Bankruptcy April 25, 1980), *Knezel* v. *Security Industrial Bank*, 3 B.R. 629, 80 M 0024 (D.Colo.Bankruptcy April 25, 1980) and *Hoops* v. *Freedom Finance and Security Industrial Bank*, 3 B.R. 635, No. 80 K 0294 (D.Colo.Bankruptcy April 25, 1980). The Court concurs with the reasoning on this point enunciated in these cases. As a result, Section 522(f), if constitutional, must be retroactively applied to the defendants' liens.

Does Section 522(f) of the Bankruptcy Code offend the due process guaranty of the Fifth Amendment by destroying rights conferred by the Creditors' security interests? Clearly, Congress has the broad power "To establish . . . uniform laws on the subject of Bankruptcy throughout the United States." U.S.Const. art. 1, § 8, cl. 4. The question is whether Section 522(f) modifies the Creditors' right, remedial or substantive, to such an extent as to deny them due process of law.

Several cases in which the Supreme Court considered the constitutionality of the retroactive application of statutes will be examined. *Continental Illinois Nat. Bank & T. Co.* v. *Chicago Etc., Co.*, 294 U.S. 648, 55 S.Ct. 595, 79 L.Ed. 1110 (1935) concerned

the reorganization of a railroad under Section 77 of the former Bankruptcy Act. The Supreme Court, by relying upon Congress's express power to pass uniform laws on bankruptcy, rejected the creditors' contentions that an injunction restraining the sale of collateral securing their notes violated the Fifth Amendment. The Court sustained this exercise of bankruptcy power because "The injunction here goes no further than to delay the enforcement of the contract. It affects only the remedy." *Id.*, p. 681, 55 S.Ct. p. 608. The Court noted that the statute did not directly impair the obligation of the contracts themselves.

*Kuehner* v. *Irving Trust Co.*, 299 U.S. 445, 57 S.Ct. 298, 81 L.Ed. 340 (1937) concerned a section of the former Bankruptcy Act which limited the claim of a landlord for indemnity under a lease to three years' rent. The Supreme Court indicated that the landlord did not have a lien on the debtor's assets and noted that she would get back her property. Therefore, Congress had not taken away all of her remedies under the lease. Concluding the statute did not violate the Fifth Amendment, the Court stated at page 452, 57 S.Ct. at page 301:

> While . . . the Fifth Amendment forbids the destruction of a contract it does not prohibit bankruptcy legislation affecting the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, if the statutory provisions are consonant with a fair, reasonable, and equitable distribution of those assets.

In *Gelfert* v. *National City Bank of New York*, 313 U.S. 221, 61 S.Ct. 898, 85 L.Ed. 1299 (1941),

the Supreme Court sustained a New York statute limiting the right of creditors to recover a deficiency after a sale of mortgaged property. The Court at page 231, 61 S.Ct. at page 901-902 stated:

> "Not only are existing laws read into contracts in order to fix obligations as between the parties, the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order." (cite omitted)

However, the Court stated clearly that the New York statute:

> "[C]annot fairly be said to do more than restrict the mortgagee to that for which he contracted, namely, payment in full." Here . . . the obligation of the mortgagee's contract is recognized; the statute does no more than limit "that right so as to prevent his obtaining more than his due." (cites omitted) *Id.* at pp. 234, 235, 61 S.Ct. at p. 903.

Thus, generally, rights which may be constitutionally altered by retroactive statutes include rights relating to the timing of the enforcement of a remedy and the extent of the remedy so long as any alteration is not unreasonable and arbitrary. Rights which are constitutionally protected include rights to specific property, to realize upon security for a debt, and to avoid having a contract completely destroyed.

Is the voiding of the defendants' liens on the Debtors household goods, which are nonpossessory, nonpurchase-money security interests under Colorado law, prohibited by the Fifth Amendment? The Supreme Court considered the question of whether a mortgagee's lien on real property is constitutionally

protected in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935) and in *Wright* v. *Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 57 S.Ct. 556, 81 L.Ed. 736 (1937). Those cases involved two different enactments of the Frazier-Lemke Act which concerned proceedings in bankruptcy. *Radford* declared the first enactment unconstitutional while *Vinton Branch* upheld the amended version.

In *Radford*, the Court held that because the first Frazier-Lemke Act "[P]urports to take away rights of the mortgagee in specific property" retroactively, that bankruptcy legislation invalidated under the Fifth Amendment. *Id.* p. 589, 55 S.Ct. p. 863. The rights recognized by state law taken from the creditor in *Radford* were:

> (1) The right to retain the lien until the indebtedness thereby secured is paid.
>
> (2) The right to realize upon the security by judicial public sale.
>
> (3) The right to determine when such sale shall be held, subject only to the discretion of the court.
>
> (4) The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.
>
> (5) The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt. *Id.* pp. 594 and 595, 55 S.Ct. pp. 865-866.

Under the Colorado Uniform Commercial Code, the defendants have substantially the same rights as the mortgagee in *Radford* and those rights would be completely lost if their liens were avoided under Section 522(f).

In *Vinton Branch* the Court held constitutional the amended Frazier-Lemke Act, which restored three of the five rights which were taken from the creditor by the first Act. However, that case is not pertinent to this matter. Section 522(f), if enforced, would completely void the defendants' liens thereby taking all of their rights recognized by Colorado law and by the Court in *Radford*. This distinction between the effect of the amended Frazier-Lemke Act and Section 522(f) is clarified by the Supreme Court's decision in *John Hancock Mut. Life Ins. Co.* v. *Bartels*, 308 U.S. 180, 60 S.Ct. 221, 84 L.Ed. 176 (1939) where it stated at page 187, 60 S.Ct. at page 224:

> The scheme of the [amended Frazier-Lemke Act] is designed to provide an orderly procedure so as to give whatever relief may properly be afforded to the distressed farmer-debtor, while protecting the interests of his creditors by assuring the fair application of whatever property the debtor has to the payment of their claims, the priorities and *liens of secured creditors being preserved.* (insert added, emphasis added, cites omitted)

As noted, under Section 522(f) a creditor's lien can be avoided to the extent of a debtor's exemptions under Section 522(b). In the instant case, since no item of household goods exceeds $200.00 in value, the liens could be avoided in their entirety. The liens would not be preserved.

The government contends that the *Radford* case is moribund. However, the 95th Congress believed *Radford* was still viable when enacting the Bankruptcy Code. The legislative history of Section 361 of the Code states:

> The concept of adequate protection is derived from the Fifth Amendment protection of property interests as enunciated by the Supreme Court. See *Wright* v. *Union Central Life Ins. Co.*, 311 U.S. 273, 61 S.Ct. 196, 85 L.Ed. 184 (1940); *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935). S.Rep. No. 95-989, 95th Cong.2d Sess. (1978), p. 49, U.S.Code Cong. & Admin. News 1978, p. 5835.

That secured creditors should not be denied the benefit of their bargain is, of course, the basis of adequate protection. Any evidence that the Supreme Court has ignored *Radford* is not persuasive (see, e.g., *Armstrong* v. *United States*, 364 U.S. 40, 80 S.Ct. 1563, 4 L.Ed.2d 1554 (1960)). The *Radford* opinion has been neither overruled nor weakened. *Rodrock*, *Knezel*, and *Hoops*.

However, *Radford* relates to rights of lienors of real property and not to rights of lienors of personalty. Are the Creditors' rights comparable to the realty mortgagee's rights in *Radford?* In *Advair* v. *Bank of America Nat. Trust & Savings Ass'n.*, 303 U.S. 350, 58 S.Ct. 594, 82 L.Ed. 889 (1938), the Supreme Court approved, under the amended Frazier-Lemke Act, the deduction of the costs of harvesting a crop from the gross proceeds of the crop's sale while the crop was subject to a chattel mortgage. Although the question of the due process rights of the chattel

mortgagee was not directly at issue, the Court cited *Vinton Branch* as authority for its decision and gave no indication that the creditor, secured by chattels, had fewer rights than or different rights from the creditor secured by realty. Further, as stated in *Rodrock* and *Knezel* at page 632:

> Any lien is a matter of property and not a mere matter of procedure. (cites omitted) Moreover, for constitutional purposes, it makes no difference whether liens are on personal property or real property. (cites omitted)

Finally, Section 522 allows the Debtors to avoid the fixing of a *lien*. "Lien" is defined by the Code to mean a "[C]harge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(28). This definition of lien includes security interests. H.R. No. 95-595, 95th Cong., 1st Sess. (1977), p. 312 and S.Rep. No. 95-989, 95th Cong. 2d Sess. (1978), p. 25. As defined in the Code, "security interest" is similar to that same term in the Colorado Uniform Commercial Code and includes all U.C.C. security interests. 11 U.S.C. § 101 (37). C.R.S. 1973, 4-1-201(37), as amended, H.R. No. 95-595, 95th Cong. 1st Sess. (1977), p. 314, U.S.Code Cong. & Admin.News 1978, p. 5787 and S.Rep. No. 95-989, 95th Cong., 2d Sess. (1978), p. 26, U.S.Code Cong. & Admin.News 1978, p. 5787. However, the term as used in the Bankruptcy Code is broader in that it includes real property mortgages. *Id.* Hence, the Code itself equates a security interest in personal property with a security interest in real property.

Not all retroactive statutes are unconstitutional. Case law discloses that the Supreme Court balances

consideration to determine whether the retroactive application of a statute is unreasonable and denies due process of law. Under Colorado law, the Creditors' liens give them rights in specific property of the Debtors. That property is security for the debts owed them. The voiding of the defendants' liens would not simply affect some of their remedies; it would completely destroy their contracts with the Debtors. Although Congress may affect contracts through the exercise of its bankruptcy power, it may not completely destroy them. Congress's bankruptcy power is limited by the due process clause of the Fifth Amendment. *Radford* clearly demonstrates that the Creditors' liens on the Debtors' household goods may not be abrogated by the Bankruptcy Code. Section 522(f) of the Bankruptcy Code may not be constitutionally applied to the security interests obtained by Security Industrial Bank or Liberty Loan Corporation in the instant cases.

ORDERED that the Complaints to Void Liens of Security Industrial Bank and Liberty Loan Corporation Under Section 522(f) of the Bankruptcy Code are dismissed.

APPENDIX F

IN THE
UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

No. 79-11718

In Re: RANDALL DEAN SCHULTE
OLLIE DENISE SCHULTE, DEBTORS

*vs.*

BENEFICIAL FINANCE OF
KANSAS, INC., DEFENDANT

No. 79-11745

In Re: RICHARD GLEN HUNTER
SHARON KAY HUNTER, DEBTORS

*vs.*

BENEFICIAL FINANCE OF
KANSAS, INC., DEFENDANT

## MEMORANDUM OF DECISION

These proceedings arose from the debtors' applications to avoid nonpurchase-money, nonpossessory liens of a creditor pursuant to 11 U.S.C. § 522(f). The creditor, in response to the debtors' applications, objects to the lien avoidance claiming that 11 U.S.C. § 522(f), if applied retrospectively, violated Fifth Amendment due process in taking property without a meaningful hearing and without compensation. As the separate debtor applications were against the same creditor and involved the same issue of law, the cases were joined for this decision.

Subsequent to the joining of issues, an opportunity was afforded the Attorney General of the United States, pursuant to 28 U.S.C. § 2403, to intervene and present legal briefs and arguments on the presented question which could involve the constitutionality of 11 U.S.C. § 522(f).

The parties and the United States have submitted memoranda and the controversy is now ready for decision.

## FINDINGS OF FACT

The facts in these cases are not in dispute. The petitions for an order for relief were filed after October 1, 1979. The liens of the creditor are non-purchase-money, nonpossessory liens on property of the debtors. Were it not for the liens the property would be unencumbered. The property is exempt pursuant to the request of the debtors made under applicable state and federal statutes. The liens therefore impair the debtors' entitled exemptions, a prerequisite to invoking 11 U.S.C. § 522(f). The loans giving rise to the liens were made both before the November 6, 1978 enactment date and the October 1, 1979 effective date of the Bankruptcy Code.

## ISSUE

Is 11 U.S.C. § 522(f) to be given retrospective effect from either the effective or enactment date of Title 11 of the United States Code?

## CONCLUSIONS OF LAW

The debtors and the United States, through the Executive Office for the United States Trustees, take the position that Article 1 § 8 of the Constitution of the United States has the effect of preemption of the

field of bankruptcy and that the laws pertaining thereto passed by Congress supersede any state or other law to the contrary. The position is further taken that only states are prohibited by Article 1 § 10 of the Constitution from impairment of contracts while the federal government, through Congress, is not so constrained. *cf. Hanover National Bank* v. *Moyses*, 186 U.S. 181 (1902). From these well-founded general concepts the debtors and intervenor conclude that what § 522(f) of Title 11 U.S.C. does is to merely alter a contract or at most deprive creditors of an insubstantial property right. They state that, since in many instances the property value to creditors in these cases is negligible, such value was not the basis of the creditor's bargain with the debtor. Thus, being insubstantial, it can be ignored. They also submit that any loss suffered through loss of security may be offset by the ability to share pro rata with unsecured creditors from the general estate. It is further argued that retrospectivity should be effectuated as § 522(f) has raised expectations of lien avoidance in the hearts and minds of the debtors and that this expectation should be honored.

The debtors and intervenor, in support of their theories, submitted a number of cases which can be generally categorized as follows. The Legal Tender cases: *Knox* v. *Lee* and *Parker* v. *Davis*, 79 U.S. 457 (1870), and the Gold Clause cases: *Norman* v. *Baltimore* and *Ohio Ry. Co.*, 294 U.S. 240 (1935); *Nortz* v. *U.S.*, 294 U.S. 317, *Perry* v. *U.S.*, 294 U.S. 330, concern exercise of contract powers and of currency regulation granted Congress pursuant to Article 1 of the Constitution. In those cases, since the parties were dealing with legal tender or currency,

it was essentially held that a substitution of one form of legal tender or currency for another was merely a substitution of equal items constituting legal tender as defined by Congress. Though as a commodity gold may have greater value at one time than another, as legal tender, it has only such value as ascribed to it as specie. Other cited cases involve an impairment of contract, such as a delay in realization of a right, or takings for which compensation is required for partial destruction of property rights or exercise of police power. *cf. Hadacheck* v. *Los Angeles*, 239 U.S. 394 (1915); *Portsmouth Co.* v. *U.S.*, 260 U.S. 327 (1922); *Miller* v. *Schoene*, 276 U.S. 272 (1928); *Wright* v. *Vinton Branch*, 300 U.S. 440 (1937).

The creditor, of course, disagrees with the conclusion drawn by the debtors and the United States. The creditor does not believe that impairment is a strong enough word to use when describing the effect of § 522(f) on its perfected lien rights. The creditor believes "extinguishment" is the more appropriate word. The creditor also believes its right is substantial enough to merit due process protection and concludes that the ability to share pro rata with unsecured creditors is not compensation for the loss of its security. It should be noted that the ability of a secured creditor to share with general creditors, should it give up its security or should it exercise its secured rights and have a deficiency, is not a newly granted right but existed under the Bankruptcy Act. Experience has shown that the right in a secured creditor of giving up its security and sharing pro rata with unsecured creditors has had a paucity of exercise. Further, though the debtors may have a hope of retrospective application, and thus lien avoidance fulfills this expectation, the creditor has a reasonable expectation that its perfected lien obtained

before enactment of the new bankruptcy Code would be honored and submits that it is this expectation which should be honored.

Having set forth the opposing theories of the parties, the Court now proceeds to resolution of the issue. As there is no contention that 11 U.S.C. § 522 (f) is unconstitutional if applied prospectively, we are only concerned with whether it may apply retrospectively either from date of enactment or postponed effect.

As a general rule, courts abhor giving retrospective application to statutes. *Greene* v. *United States*, 376 U.S. 149 (1964); *Winfree* v. *Northern Pacific Railway Co.*, 227 U.S. 296 (1913). Another general rule of statutory construction is that a statute is to be construed so as to preserve its constitutionality where possible. Thus, if a statute may be construed two ways one of which preserves and one of which destroys its constitutionality, the former choice is to be made. *Wright, supra.*

The creditor herein has a perfected security interest giving it a lien on specific property of the debtors. This lien was freely and voluntarily given by the debtors, no contention to the contrary having been made. As defined by 11 U.S.C. § 101(28), such a lien is a charge against or an interest in property. The creditor therefore has a lien which is an interest or right in specific property. Property rights in both personal and real property are afforded protection pursuant to the Fifth Amendment. *Armstrong* v. *U.S.*, 364 U.S. 40, 44-46 (1960); *Louisville Bank* v. *Radford*, 295 U.S. 555 (1935); *Ginsberg* v. *Lindel*, 107 F.2d 721 (8th Cir. 1939). As the creditor has a property right subject to Fifth Amendment protection, to take that property right from the creditor without adequate compensation is a violation of a

constitutional right afforded to that creditor. Though the debtors and the United States submit that the creditor has the ability to share in the general estate in exchange for its security, that right exists with or without such an exchange and denial of right to the creditor. In most instances the right to share in general assets of an estate is relatively valueless and certainly, even if it were newly granted, cannot be compared to retention of a right to collateral. In this instance, since it is not a newly granted right, the creditor has a right to its collateral and a right to claim as a general creditor for any deficiency between the value of that collateral and the obligation owed it. Under the circumstances, to say loss of collateral is compensated for by being allowed to continue as a general creditor is ludicrous.

Having determined that the creditor has a property right entitled to due process protection, the question remaining to be resolved is whether or not the effective date or enactment date is the date beyond which lien avoidance denies due process. *Ettor* v. *Tacoma*, 228 U.S. 148 (1913); *Louisville Bank*, *supra*, hold that due process is denied if one is deprived of a pre-existing vested property right by enactment of law. Other cases stand for the proposition that parties are on notice of all provisions of a statute once enacted even though its effect is postponed. *North Laramine Land* v. *Hoffman*, 268 U.S. 276 (1925); *Diamond Glue Co.* v. *U.S. Glue Co.*, 187 U.S. 611 (1903); *McClure* v. *Oxford*, 94 U.S. 429 (1876). These cases, though they can be distinguished from the instant case since they deal with contract rights rather than property rights, would be supportive of lien avoidance from and after the November 6, 1978 enactment date. They do not, however, require that conclusion as other cases allow a postponed date, the effective

date, to control. *U.S.* v. *Burr*, 159 U.S. 78 (1895); *McElrath* v. *U.S.*, 102 U.S. 426 (1880). Where no time is set for a statute to go into effect and no constitutional or general statutory provision governs, a statute becomes effective on the day of its passage or enactment into law. *Robertson* v. *Bradbury*, 132 U.S. 491 (1889); *Lapeyre* v. *U.S.*, 84 U.S. 191 (1872). Conversely, if a statute itself schedules a specific effective date, it is that postponed date and not the earlier date of enactment which controls. *U.S.* v. *Heth*, 7 U.S. 398 (1806).

Title 11 U.S.C. § 402 states at subsection (a):

> . . . *except as otherwise provided in this title, this Act shall take effect on October 1, 1979.*

Title 11 U.S.C. § 522(f) which took effect on October 1, 1979 reads as follows:

> *Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such a lien impairs an exemption to which the debtor would have been entitled under subsection (b)* of this section, . . .

It was pursuant to § 522 that the federal exemptions were created. Since the federal exemptions were not effective until October 1, 1979, no lien could impair them until that date. Any lien which would have the capacity to impair on October 1, 1979 would have been created in property pre-October 1, 1979. Newly enacted and effective exemption laws are inapplicable to existing creditors and cannot change their existing property rights. See *Bank of Minden* v. *Clement*, 256 U.S. 126 (1921). The 1910 Bankruptcy Act amendment which allowed the trustee to become the hypothetical lien creditor on the date of adjudication was held in *Holt* v. *Henley*, 232 U.S.

637 (1914), to have only prospective application. The Court in *Holt* would not allow impairment of existing lienholder rights. It was further stated that whether the power of Congress was limited or not, usual statutory construction confines a statutes affect to subsequently acquired property rights.

The Court concludes that only those liens created subsequent to October 1, 1979 may be voided by calling upon the powers granted by 11 U.S.C. § 522 (f). To allow those powers to be applied as of the date of enactment rather than the effective date would allow retrospective application and thus run headlong into the general rule against such application and again bring into focus due process denial and constitutionality as addressed above. The creditor's property rights vested at the time of the transaction. They cannot thereafter be denied without violation of the same constitutional right for the same reasons previously set forth in this opinion. The legislative history indicates the delay between the enactment and effective dates was to enable the court structure to prepare for life under the new Code. Certainly, it is no less necessary to grant that same period to the citizenry to allow it some familiarity with and time for preparation for the sweeping change in this area before requiring compliance with statutes not yet effective.

The foregoing constitutes Findings of Fact and Conclusions of Law under Bankruptcy Rule 752 and Rule 52(a) of the Federal Rules of Civil Procedure.

Dated at Topeka, Kansas this 24 day of October, 1980.

/s/ James A. Pusateri
JAMES A. PUSATERI
Bankruptcy Judge

APPENDIX G

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Nos. 80-1549
through 80-1553,
and 80-2267, 80-2268

DONALD LEE RODROCK, ET AL.,
PLAINTIFFS-APPELLANTS

*v.*

SECURITY INDUSTRIAL BANK, DEFENDANT-APPELLEE
and consolidated cases

---

NOTICE OF APPEAL

The United States of America hereby appeals to the Supreme Court of the United States, pursuant to 28 U.S.C. 1252 and 2101(a), from the judgment of this Court entered on March 2, 1981.

Dated this 1st day of April, 1981.

/s/ Michael Kimmel
MICHAEL KIMMEL
Attorney
U.S. Department of Justice

## APPENDIX H

## SUPREME COURT OF THE UNITED STATES

No. A-956

UNITED STATES, APPELLANT

*v.*

SECURITY INDUSTRIAL BANK, ET AL.

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## ORDER

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UPON CONSIDERATION of the application of the Solicitor General,

IT IS ORDERED that the time for docketing an appeal in the above-entitled case be, and the same is hereby, extended to and including July 30, 1981.

/s/ Byron R. White
BYRON R. WHITE
Associate Justice of the Supreme Court of the United States

Dated this 21st
day of May, 1981.

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# Motion to Dismiss or Affirm

1

Office - Supreme Court, U.S.
FILED
NOV 16 1981
ALEXANDER L. STEVAS,
CLERK

No. 81-184

In the
Supreme Court of the United States

OCTOBER TERM, 1981

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UNITED STATES OF AMERICA, *Appellant*
v.
SECURITY INDUSTRIAL BANK, ET AL.

---

# ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

---

# MOTION TO AFFIRM JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT UNDER RULE 16C OF THE RULES OF THE SUPREME COURT

MICHAEL E. KATCH
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In the

Supreme Court of the United States

OCTOBER TERM, 1981

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No. 81-184

UNITED STATES OF AMERICA, *Appellant*

v.

SECURITY INDUSTRIAL BANK, ET AL.

---

# ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

---

# MOTION TO AFFIRM JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT UNDER RULE 16C OF THE RULES OF THE SUPREME COURT

COME NOW the Appellees, Security Industrial Bank and Liberty Loan Corporation through their attorneys, Katch, Anderson, Madsen & Wasserman and move this Court for an Order affirming the decision of the United States Court of Appeals for the Tenth Circuit under Rule 16C of the Rules of the Supreme Court of the United States and as grounds therefor states that it is manifest that the questions on which the decision of the Appellant's cause depends are so unsubstantial as not to require further argument:

## I

## STATEMENT OF THE CASE

The Bankruptcy Reform Act was enacted into law on November 6, 1978. One provision of that law 11 U.S.C. §522(f) provided that certain liens which impaired exemp-

tions could be voided to the extent of the exemption. A full restatement of the applicable provision is in the Solicitors Jurisdictional Statement and the cases appealed which are an appendix thereto.

Security Industrial Bank and Liberty Loan Corporation were the subject of Complaints to Void Liens under §522(f) in the United States Bankruptcy Court for the District of Colorado. In each case the Appellees filed a Motion to Dismiss on the grounds that the voiding of their preenactment security interest in household goods would be a violation of the Fifth Amendment of the United States Constitution citing *Louisville Joint Stock Land Bank vs. Radford*, 295 U.S. 555 (1935).

The United States intervened to defend the constitutional question after receiving notice under 28 U.S.C. 2403(a). The decisions rendered by the Bankruptcy Court were: *Rodrock vs. Security Industrial Bank* and *Knezel vs. Security Industrial Bank* (Appendix C after the Jurisdictional Statement); *Hoops vs. Freedom Finance and Security Industrial Bank* (Appendix D of the Jurisdictional Statement); *Jackson vs. Security Industrial Bank* and *Stevens vs. Liberty Loan Corp.* (Appendix E of the Jurisdictional Statement).

All four Bankruptcy Judges for Colorado found that Congress intended §522(f) to be applied retrospectively but that when applied to security interests perfected prior to the enactment of the Bankruptcy Code it was unconstitutional under the Fifth Amendment citing *Radford* supra.

At about the same time, *Schulte vs. Beneficial Finance* and *Hunter vs. Beneficial Finance* were decided by the Bankruptcy Court for the District of Kansas. That Court found that §522(f) was to be applied prospectively only because of the constitutional problem when it is applied retroactively. (Appendix F of the Jurisdictional Statement)

The Colorado and Kansas decisions were, by Stipulation between the parties, directly appealed to the United States Court of Appeals for the Tenth Circuit pursuant to 28 U.S.C. §1293(b) (made applicable by §405(c) of the Bankruptcy Reform Act) and consolidated. The Tenth Circuit adopted the decisions of the Colorado Bankruptcy Judges, ruling that §522(f) was intended to be applied retrospectively and that when so applied it violated the Fifth Amendment relying again on *Radford*.

The matter is before this Court pursuant to 28 U.S.C. 1252.

## II

## ARGUMENT

The Tenth Circuit first addressed the retroactive question finding that "The Reform Act is either to be retroactively applied, or to be applied only in a prospective manner." (page 9 of the Jurisdictional Statement.) In finding that retroactive application was intended, the Tenth Circuit notes that if the Reform Act was intended to apply only prospectively from its date of enactment a "gap" and "no man's land" would be created with "no bankruptcy law governing." (page 8 of the Jurisdictional Statement.)

It should be noted that the Solicitor has not raised the retrospective/prospective question in the Jurisdictional Statement.

Going next to the constitutional question, the Tenth Circuit noted that "in the instant cases there would be a complete taking of the secured creditors property interests." (page 10(a) of the Jurisdictional Statement.) The only question addressed by the Tenth Circuit was the Government's contention that "*Radford* has lost its steam and that later decisions of the Supreme Court cast doubt on

the continuing vitality of that decision." (page 10(a) of the Jurisdictional Statement.) The Government had cited *Wright vs. Vinton Branch of the Mountain Trust Bank of Roanoke*, 300 U.S. 440 (1937) and *Kuehner vs. Irving Trust Co.*, 299 U.S. 440-445 (1937) among other cases as examples of the retreat from *Radford*. The Tenth Circuit disagreed and in footnote 5 (page 10(a) wrote, "We note that, not only has Radford never been overruled, either expressly or impliedly, but it has continued to be cited by the Supreme Court" citing *Armstrong vs. United States*, 364 U.S. 40, 44 (1960)

It is significant and substantial to the within Motion to Affirm that the other arguments briefed and presented to the Tenth Circuit were not acknowledged in their written opinion. It is the position of this Motion that they were so unsubstantial as not to merit response there nor do require argument before this Court. They are however raised in the Solicitor's Jurisdictional Statement at page 13.

They are as follows:

1. That security interests of the kind to be voided by §522(f) do not have the same substantial values as the mortgage interest considered in *Radford*.
2. That the threat of repossession allows creditors to exercise "coercive powers" disproportionate to their economic interests.

## III

## WHY THE QUESTIONS RAISED BY THE SOLICITOR ARE SO UNSUBSTANTIAL AS NOT TO NEED FURTHER ARGUMENT

While the Solicitor has apparently abandoned the argument that *Radford* has been enervated by subsequent decisions, it should be noted that it was most recently cited by

this Court on July 2, 1981 in the case of *Moore vs. Regan*, Case No. 80-2078 wherein Justice Powell in his concurring opinion states that:

> ". . . moreover because it is settled that an attachment entitling the creditor to resort to specific property for the satisfaction of a claim is a property right compensable under the Fifth Amendment, *Armstrong vs. The United States*, 364 U.S. 40 (1960), *Louisville Bank vs. Radford*, 295 U.S. 555 (1935) there is a question whether the revocability of the license under which petitioner obtained its attachment suffices to render revocable the attachment itself. . ."

The Solicitor instead of arguing that Radford is no longer good law now argues that it is only to "be viewed in its specific factual context" and attempts to distinguish it from the instant cases. Yet as was noted by the Tenth Circuit, in the instant cases there would be a complete taking of the secured creditor's property interest. In *Radford* on the other hand Justice Brandeis addressed a law (the original Frazier-Lemke Act) which left many rights in the mortgaged property with the secured creditors (see the Bankruptcy Court's opinion in *In re Hoops* at page 37(a) of the Jurisdictional Statement where an analysis of the totalness of the taking under §522(f) is set forth and contrasted with mere impairment of enforcement of liens under Frazier-Lemke).

Indeed, none of the cases cited by the Solicitor for the compromising of *Radford* where "in at least some instances liens and secured claims may be voided, limited or subordinated to other interests by a bankruptcy court" (at page 10 of the Jurisdictional Statement) stand for the proposition that a lien upon specific property, may be extinguished. The cases cited at page 11 of the Jurisdictional

Statement do not blur what the Solicitor refers to as the "rigid line" interpretation of *Radford* by the Tenth Circuit they substantiate it. The "rigid line" the Solicitor refers to is in fact the fence between the impairment of contract rights and the retrospective taking of property without compensation or due process of law. It is the crux of the Fifth Amendment.

The next question the Solicitor raises is that the security interests which are voidable by §522(f) "do not have the same substantial value as the mortgage interests considered in *Radford.*" No case law has been presented by the Solicitor for the proposition that the dollar amount of a lien has some relation to the degree of constitutional protection afforded it. Another way to state the question is, can Congress impose a Two Hundred Dollar threshhold on the Fifth Amendment (§522(f) only voids a lien on household goods to the extent of the first Two Hundred Dollars value in each item.) All four Bankruptcy Judges for the District of Colorado dismissed these arguments and the Tenth Circuit did not respond to them. They deserve the same response by this Court.

The last question presented by the Solicitor is based on Congress's characterization of security interests on personal consumer property as "contracts of adhesion." Congress went on to find "that the threat of repossession of highly personal possessions enables creditors to exercise *coercive power* disproportionate to their economic interests and forces debtors into making payments they cannot afford." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977) at p. 127. Stated another way, the issue is whether Congress in legislative hearing can make a finding that *all* creditors acquiring non-possessory, non-purchase money security interests in household goods are morally blameworthy and therefore not entitled to the protection of the Fifth Amendment? Again, the Solicitor cites no law to support this con-

tention. It should be noted that lumping all such creditors together as morally blameworthy and then "punishing them" by the retroactive imposition of §522(f) constitutes what could be deemed a civil bill of attainder. See *Usery vs. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976) at p. 17 where Mr. Justice Marshall said:

> "We would hesitate to approve the retrospective imposition of liability on any theory of blameworthiness."

## IV
## CONCLUSION

The Solicitor raised the following questions with regard to *Radford*: (1) it has been enervated and/or compromised by subsequent case law; (2) it should be limited to the facts presented therein; (3) it is distinguishable from the instant case on two grounds, the dollar value of liens and the moral character of the lienholders. As shown supra, these questions are so unsubstantial as not to require further argument.

That does not mean however that this case is unsubstantial. The principal in *Radford* restated in the cases on appeal from the Tenth Circuit is fundamental and of utmost importance. By affirming the Tenth Circuit without argument, this Court will be strongly restating what should have been an obvious constitutional principal in the first place.

Respectfully submitted,

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# Motion to Dismiss or Affirm 2

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No. 81-184

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

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UNITED STATES OF AMERICA, *Appellant*

v.

SECURITY INDUSTRIAL BANK, *et al.*

---

## MEMORANDUM IN RESPONSE TO JURISDICTIONAL STATEMENT

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## MEMORANDUM IN RESPONSE TO JURISDICTIONAL STATEMENT

---

Beneficial Finance of Kansas, Inc. ("Beneficial"), one of the appellees herein, responds to the Jurisdictional Statement filed by appellant United States of America and respectfully urges this Court to note probable jurisdiction in this case. Although Beneficial differs with and opposes the government's position on the merits, it believes that the constitutional issues presented by this case are substantial and are of such pervasive importance that the Court should note probable jurisdiction.

At present, confusion reigns among debtors, creditors and courts, and it is respectfully submitted that such confusion will continue unless this Court resolves the fundamental constitutional questions presented.

The government's Jurisdictional Statement presents a question relating to the constitutionality of the retroactive application of §522(f) of the Bankruptcy Reform Act of 1978, 11 U.S.C. (Supp. III), a statutory provision which permits debtors to avoid certain non-purchase-money, non-possessory liens. As more fully set out in the government's Jurisdictional Statement, the constitutionality of this provision has sharply divided Bankruptcy Courts all over the country. (See government's Jurisdictional Statement, p. 8, fn. 5). Some lower courts have held the statute constitutional, some have held the statute unconstitutional as applied to security interests created prior to the enactment of the Bankruptcy Reform Act, and some courts have avoided the constitutional question by construing the statute so as to be inapplicable to security interests created prior to the Bankruptcy Reform Act. Appeals raising questions identical to or closely related to the question presented in the government's Jurisdictional Statement are now pending in four circuits other than the Tenth Circuit in which the instant case arose. (See government's Jurisdictional Statement, p. 9, fn. 6).

This question presented in the government's Jurisdictional Statement itself, without reference to other related issues described *infra,* is of great importance to the Nation's economy and the administration of the bankruptcy law. The number of bankruptcy cases filed annually in the United States has risen dramatically since enactment of the Bankruptcy Reform Act.* Beneficial is informed that a substantial number of these

---

* The Bankruptcy Reform Act became effective October 1, 1979. According to the Administrative Office of U.S. Courts, more than 500,000 bankruptcy proceedings involving millions of creditors were filed in the year ending June 30, 1980.

cases involve applications to avoid liens filed pursuant to §522(f) of the Bankruptcy Reform Act. The confusion created by inconsistent rulings regarding the constitutionality of the statute will continue unless and until the Court finally resolves this issue. Beneficial agrees with the Tenth Circuit to the extent it holds that §522(f), construed to apply retroactively, is unconstitutional, in violation of the Fifth Amendment. It believes, however, that an authoritative ruling by this Court resolving any doubt is necessary and, therefore, urges that probable jurisdiction should be noted.

In addition to the question described in the government's Jurisdictional Statement, Beneficial has urged this Court that the appeal necessarily requires adjudication of a fundamental constitutional issue which infects thousands of bankruptcy proceedings. The issue is whether, pursuant to the Bankruptcy Reform Act of 1978, Congress, despite the provisions of Article III, may vest in non-tenured bankruptcy judges the power to adjudicate, independently of the District Courts and Judges, all matters under Title 11 of the United States Code; and consequently, whether such bankruptcy judges may exercise the powers vested in them by the Bankruptcy Reform Act of 1978.

The fundamental jurisdictional and constitutional nature of this issue affects the validity of every action taken by any Bankruptcy Court since October 1, 1979. It calls into question the legality of pending bankruptcy proceedings initiated in the United States since the effective date of the Bankruptcy Reform Act and, therefore, affects the millions of debtors and creditors involved in the hundreds of thousands of proceedings filed annually. The issue has already been raised in various pending bankruptcy proceedings.

Although this pervasive issue was not raised by motion or otherwise below and was not considered by the Tenth Circuit or the parties, Beneficial believes that its resolution is necessary and appropriate in connection with the appeal presented by the government herein. Accordingly, on September 18, 1981, Beneficial filed its Motion to Enlarge Question Presented by which it seeks to have the Court add the Article III issue to the question presented in the government's appeal in this case. In addition, on September 18, 1981, Beneficial timely filed a cross-appeal in this case which presents the same question raised by Beneficial's Motion to Enlarge Question Presented.

The Article III question has also been presented to this Court in the context of the provisions of the Bankruptcy Reform Act granting bankruptcy judges "extended jurisdiction": that is, to assume and exercise jurisdiction and to adjudicate cases and controversies previously outside the bankruptcy jurisdiction. Appeals have been docketed, and jurisdictional statements filed in this Court in *Northern Pipeline Construction Co.* v. *Marathon Pipeline Company,* No. 81-150, and *United States* v. *Marathon Pipeline Company,* No. 81-546. Those cases are appeals from a ruling of the United States District Court for the District of Minnesota which held that the Bankruptcy Court lacked jurisdiction to hear certain claims asserted in bankruptcy proceedings because 28 U.S.C. §1471, the provision of the Bankruptcy Reform Act which purports to confer "extended jurisdiction" upon the Bankruptcy Court, "is an unconstitutional delegation of Article III power to nontenured judges." The instant case, on the other hand, raises the Article III issue in the related context of traditional bankruptcy jurisdic-

tion. Accordingly, Beneficial has filed a Motion to Consolidate or Coordinate the appeals in 81-150 and 81-546 with the appeal herein and with Beneficial's cross-appeal.

In view of the foregoing, Beneficial respectfully submits that the Court should note probable jurisdiction in this case and should address both the constitutionality of §552(f), and the constitutionality of the Bankruptcy Courts in light of the impact of Article III.

Respectfully submitted,

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# Appellant's Brief

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*ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

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## BRIEF FOR THE UNITED STATES

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## QUESTION PRESENTED

Whether Section 522(f)(2) of the Bankruptcy Code, 11 U.S.C. (Supp. IV) 522(f)(2), as applied to certain nonpossessory, nonpurchase-money security interests acquired before its enactment, violates the Fifth Amendment.

## PARTIES TO THE PROCEEDING

The judgment of the court of appeals embraces seven different cases filed in bankruptcy courts and consolidated on appeal. The United States intervened in these cases in the bankruptcy courts pursuant to 28 U.S.C. 2403(a). Freedom Finance, Liberty Loan Corporation and Beneficial Finance of Kansas, Inc., were defendants in the bankruptcy court proceedings and are appellees here. The debtors, the plaintiffs in the bankruptcy court proceedings, are Donald Lee Rodrock, Janet Carol Rodrock, Pamela Sue Knezel, Rosemary Louise Hoops, Noval James Jackson, Jerrie Jackson, Paul Leroy Stevens, Sara Ann Stevens, Randall Dean Schulte, Ollie Denise Schulte (a/k/a Ollie Denise Dehne), Richard Glen Hunter and Sharon Kay Hunter. They are nominally appellees in this Court although they did not participate in this case in the court of appeals.

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### OPINIONS BELOW

The opinion of the court of appeals (J.S. App. 1a-12a) is reported at 642 F.2d 1193. The opinion of the bankruptcy court in *Rodrock* and *Knezel* (J.S. App. 16a-27a) is reported at 3 Bankr. Rep. 629. The opinion of the bankruptcy court in *Hoops* (J.S. App. 28a-40a) is reported at 3 Bankr. Rep. 635. The opinion of the bankruptcy court in *Jackson* and *Stevens* (J.S. App. 41a-51a) is reported at 4 Bankr. Rep. 293. The opinion of the bankruptcy court in *Schulte* and *Hunter* (J.S. App. 52a-59a) is reported at 8 Bankr. Rep. 12.

## JURISDICTION

The judgment of the court of appeals (J.S. App. 13a-15a) was entered on March 2, 1981. The notice of appeal (J.S. App. 60a) was filed on April 1, 1981. On May 21, 1981, Justice White extended the time for docketing the appeal to and including July 30, 1981 (J.S. App. 61a). The jurisdictional statement was filed on July 29, 1981, and the Court noted probable jurisdiction on December 14, 1981. The jurisdiction of this Court is invoked under 28 U.S.C. 1252. *Parker* v. *Levy*, 417 U.S. 733, 742-743 n.10 (1974).

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Article I, Section 8, Clause 4, of the United States Constitution provides in pertinent part:

> The Congress shall have Power * * * [t]o establish * * * uniform Laws on the subject of Bankruptcies throughout the United States.

2. The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall * * * be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

3. Section 522(f)(2) of the Bankruptcy Code, 11 U.S.C. (Supp. IV) 522(f)(2), provides:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—
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> * * * * *

(2) a nonpossessory, nonpurchase-money security interest in any—

(A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(C) professionally prescribed health aids for the debtor or a dependent of the debtor.

4. Section 522(d) of the Bankruptcy Code, 11 U.S.C. (Supp. IV) 522(d), provides in pertinent part:

The following property may be exempted under subsection (b)(1) of this section:

* * * *

(3) The debtor's interest, not to exceed $200 in value in any particular item, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor.

(4) The debtor's aggregate interest, not to exceed $500 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

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(6) The debtor's aggregate interest, not to exceed $750 in value, in any implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.

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(9) Professionally prescribed health aids for the debtor or a dependent of the debtor.

## STATEMENT

1. In 1978, Congress enacted a comprehensive revision of the federal bankruptcy laws. Pub. L. No. 95-598, 92 Stat. 2549. One of the major goals of the bankruptcy revision was to redesign for consumer debtors traditional bankruptcy protections that primarily had been concerned with business bankruptcies. See 123 Cong. Rec. 35444 (1977). In order to afford consumer debtors a "fresh start" after bankruptcy, Congress sought to preserve for the debtor a basic core of necessities that he would retain after the bankruptcy proceeding. In furtherance of this goal, Section 522(d) of the new Bankruptcy Code establishes a set of federal exemptions, applicable only to individual debtors (see 11 U.S.C. (Supp. IV) 522(b)), which identify the property that a debtor may reclaim from the bankrupt estate.[1] Examples of the items of property subject to these exemptions, up to a specified dollar limit, are the debtor's residence, motor vehicle, furniture, clothing and professional books. See 11 U.S.C. (Supp. IV) 522(d)(1), (2), (3), (6).

The provision at issue here, Section 522(f), was enacted to protect the most essential exemptions, whether provided by federal or state law, by enabling the debtor to avoid a narrow category of liens that could render the exemptions meaningless. Section

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[1] Upon commencement of a bankruptcy proceeding, the debtor's legal and equitable property interests are transferred to a separate estate from which claims are satisfied. See 11 U.S.C. (Supp. IV) 541. Under Section 522(b), however, a debtor may reclaim from the estate either property that is exempt from execution under state law or property that is defined as exempt under federal law, unless state law specifically provides that the federal exemptions are not available in that state.

522(f)(1) permits the debtor to avoid the fixing of a judicial lien on exempt property. Section 522(f)(2) permits the debtor to avoid the fixing of a nonpossessory, nonpurchase-money security interest in certain exempt property. Section 522(f)(2) does not extend to all property exempted under Section 522(d); it is limited to certain specified personal items, such as household furnishings, tools of the debtor's trade, and professionally prescribed health aids.[2] By its terms, Section 522(f)(2) has no application to a possessory interest in the debtor's property or to a purchase-money security interest, such as the security interest retained by a seller when he accepts payment for exempt property on an installment basis.[3]

2. This case involves seven different suits brought before four different bankruptcy judges, which were consolidated on appeal in the Tenth Circuit because they present identical issues. In each case, a creditor had acquired a nonpossessory, nonpurchase-money security interest in the debtor's household furnishings and appliances before the President signed into law the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, on November 6, 1978 (J.S. App. 5a). In each case, the debtor instituted bankruptcy proceedings after October 1, 1979, the effective

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[2] The items covered by Section 522(f)(2) correspond to the exemptions of Section 522(d)(3), (4), (6) and (9). All of the property involved in this case apparently falls within Section 522(d)(3) (exempting household and personal items valued at $200 or less).

[3] The Bankruptcy Code does not define "purchase-money security interest." Under the Uniform Commercial Code, purchase-money security interests are interests retained by sellers or interests that otherwise secure the obligation that financed the acquisition of the encumbered property. See U.C.C. § 9-107.

date of the Act,[4] claiming exemptions for items that were subject to the creditor's security interest (*ibid.*). When the creditors objected to these claimed exemptions, the debtor in each case filed a complaint in the bankruptcy court pursuant to Section 522(f)(2), seeking to avoid the creditor's lien (*ibid.*). In each instance, the creditor moved to dismiss the debtor's complaint, asserting that application of Section 522(f)(2) to a security interest acquired before enactment of that provision violated the Fifth Amendment (*ibid.*).

Pursuant to 28 U.S.C. 2403(a), the United States was notified that the constitutionality of a federal statute had been drawn into question, and the United States intervened in each bankruptcy court to defend the constitutionality of the statute. In all cases, the bankruptcy court dismissed the debtor's complaint. In *Rodrock* v. *Security Industrial Bank* and *Knezel* v. *Security Industrial Bank* (J.S. App. 16a-27a), the bankruptcy court concluded that the creditor's due process rights (*id.* at 23a-24a) were violated because its pre-existing "substantive right in specific property" had been "substantially impaired" (*id.* at 20a-21a, 24a). In *Hoops* v. *Freedom Finance and Security Industrial Bank* (*id.* at 28a-40a), the bankruptcy court concluded that Section 522(f), as applied retrospectively to pre-enactment liens, violated "substantive due process" (J.S. App. 32a, 39a), while noting that the Takings Clause did not ap-

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[4] Pursuant to Section 402(a) of the Act, Pub. L. No. 95-598, 92 Stat. 2682, the Act became effective as of October 1, 1979, with certain exceptions that are not relevant here. Bankruptcy proceedings commenced after that date ordinarily are to be governed by the new Bankruptcy Code; proceedings commenced before that date continue to be governed by the old Bankruptcy Code.

pear to be involved in the case (*id.* at 29a-30a). In *Jackson* v. *Security Industrial Bank* and *Stevens* v. *Liberty Loan Corp.* (*id.* at 41a-51a), the bankruptcy court concluded that Section 522(f)(2), as applied retrospectively, violated the Due Process Clause of the Fifth Amendment (J.S. App. 51a). In *Schulte* v. *Beneficial Finance of Kansas, Inc.* and *Hunter* v. *Beneficial Finance of Kansas, Inc.* (*id.* at 52a-59a), the bankruptcy court noted that retrospective application of Section 522(f)(2) created constitutional problems (J.S. App. 56a-57a) and concluded that the statute should be construed as applying only to security interests created subsequent to October 1, 1979 (*id.* at 59a). All four decisions relied heavily on this Court's decision in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935) (see J.S. App. 18a-25a, 29a-39a, 47a-51a, 56a-57a).

The court of appeals affirmed (J.S. App. 1a-11a). Disagreeing with the bankruptcy court in *Schulte* and *Hunter*, the court held that Congress intended the Bankruptcy Reform Act to apply retrospectively and thus that Section 522(f)(2) must be applied to pre-enactment security interests in bankruptcy proceedings commenced after October 1, 1979 (J.S. App. 7a-9a). Relying on *Radford*, however, the court concluded that such retrospective application is unconstitutional (*id.* at 9a-11a). The court did not explicitly state which clause of the Fifth Amendment was violated, although it did note that Section 522(f)(2) effected a "complete taking of the secured creditors' property interests" in these cases (J.S. App. 10a).

## INTRODUCTION AND SUMMARY OF ARGUMENT

This case concerns the constitutionality of Section 522(f)(2) of the new Bankruptcy Code, which permits bankrupt debtors to avoid nonpossessory, nonpurchase-money security interests in certain exempt household goods and other necessities. Congress found this provision necessary to provide consumer debtors the opportunity for a fresh start after bankruptcy. This particular type of security interest, usually created by a "contract of adhesion signed in ignorance" by the debtor, characteristically is a blanket lien on all of the debtor's household goods. Congress determined that the holders of these liens have little interest in possession of the property, which has only de minimis resale value; rather, liens are valuable because they provide a credible threat of repossession of the debtor's basic necessities in order to compel him to pay his debt or to reaffirm his debt after discharge in bankruptcy. The result is to leave the debtor burdened by debt even after discharge and thus to defeat the fresh start that is the most essential aspect of debtor relief in bankruptcy. Because, unlike other liens, the liens covered by Section 522(f)(2) do not represent a genuine interest in possession of property but instead are merely a vehicle to create leverage to compel a debtor to satisfy his personal obligation, Congress' special treatment of them, which gives the lienholder the right to collect on his debt like any unsecured creditor, does not violate the Due Process Clause or the Takings Clause of the Fifth Amendment.

### A.

Historically, the Due Process Clause has been a limitation on retroactive legislation, but statutes of general application regulating economic matters will be upheld, even as to their retroactive aspects, if they have a rational basis. Bankruptcy legislation, by its

very nature, affects creditor interests that accrued prior to enactment. Thus, the retrospective effect of a bankruptcy statute that applies only to future proceedings ordinarily raises no due process problem, and this Court consistently has sustained federal bankruptcy legislation and bankruptcy court decrees that have such an effect on creditor interests.

Section 522(f)(2) clearly satisfies the rational basis test. A major objective of the Bankruptcy Reform Act was to guarantee a fresh start after bankruptcy for consumer debtors, who were not adequately protected under existing law. Congress found that the limited class of security interests to which Section 522(f)(2) applies often had been created by "overreaching creditors" through "contract[s] of adhesion," and were used to defeat a debtor's fresh start by inducing him to reaffirm debts in order to avoid the loss of his household goods (H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 127, 163 (1977)). Accordingly, Congress sought to protect a debtor's fresh start by enacting Section 522(f)(2) to safeguard his exemptions in basic household necessities.

A special exception in the Act for liens created before its enactment would have defeated the Act's purpose of providing a fresh start for all debtors filing for bankruptcy after October 1, 1979, and would have postponed for many years a reform long overdue. Indeed, it would have been irrational for Congress to provide an exception to permit the enforcement of those very contracts that were the specific object of the legislation and that Congress had condemned as unfair. Thus, Congress did not violate the Due Process Clause in refusing to make a special exception in the case of Section 522(f)(2) to the general rule that the bankruptcy law in effect during the bankruptcy proceeding applies even to pre-existing commercial transactions.

B.

1. This Court's decision in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935), does not suggest that retrospective application of Section 522(f)(2) violates the Takings Clause. In *Radford*, the Court held unconstitutional the Frazier-Lemke Act of 1934 because of its retroactive impairment of the rights of mortgagees in farm mortgages, but the precedential effect of that case has been substantially eroded by later decisions. In particular, the court of appeals' suggestion that *Radford* establishes a sharp distinction for Fifth Amendment purposes between a lien and a contractual interest does not withstand analysis, because impairment of a right conferred by contract is not necessarily immune from challenge under the Fifth Amendment. Thus, the existence of a lien is no more than a factor to be taken into account in the takings analysis. And, while *Radford* continues to stand for the proposition that the bankruptcy power "is subject to the Fifth Amendment" (295 U.S. at 589), it is well established that, consistent with the Fifth Amendment, Congress may pass bankruptcy legislation that discharges a debt to an unsecured creditor without full payment of the debt, or that substantially impairs the rights of a secured creditor.

2. This Court has identified several factors—principally, the character of the government action and its economic impact—that are relevant in determining whether government regulation rises to the level of a taking that requires just compensation. The significant differences between this case and *Radford* that become apparent upon examining these factors demonstrate that Section 522(f)(2) does not effect a taking.

Section 522(f)(2) is an integral part of comprehensive bankruptcy legislation; it is a classic example of government regulation for the common good of the sort that ordinarily is not found to be a taking. See *Penn Central Transportation Co.* v. *New York City*, 438 U.S. 104, 124 (1978). In contrast, the Frazier-Lemke Act invalidated in *Radford* was not neutral bankruptcy legislation. The farm property involved in that case was not even subject to the debtor's right of exemption. In addition, the Frazier-Lemke Act applied *only* to pre-existing mortgages. Thus, it operated not to give the debtor a fresh start but to supply him capital with which to engage in business in the future.

3. The economic impact of Section 522(f)(2) does not rise to the level of a taking. The property interest allegedly "taken" is one of the least substantial: a nonpossessory, nonpurchase-money security interest in household goods. Unlike *Radford* and other cases in which this Court has found a taking, here there is no interference with a right in real property. Nor does Section 522(f)(2) affect property in a creditor's possession. Although these two factors were also absent in one case where this Court has found a taking, *Armstrong* v. *United States*, 364 U.S. 40 (1960), that case is of no relevance here because (1) it involved a conversion of property for the government's own use and (2) it involved materialmen's liens, which are effectively equivalent to the purchase-money security interests that Congress specifically excluded from the lien avoidance provisions of Section 522(f)(2).

The security interests held by appellees cannot be equated with the "rights in specific property which are of substantial value" involved in *Radford*. 295 U.S. at 601. A real estate mortgage involves a direct

connection between the security and the debt that is absent here. Moreover, in contrast to the Frazier-Lemke Act, where Congress found that the mortgage rights involved were so valuable that prospective application of the statute would eliminate farmers' potential sources of credit, Congress found that the household goods secured by the liens at issue in this case have virtually no value in the hands of the creditor. In addition, these liens are not interests "in specific property" as contemplated by *Radford*; Congress found that nonpossessory, nonpurchase-money security interests ordinarily are "blanket" liens on all of the debtor's household goods.

Section 522(f)(2) does not substantially impair creditors' legitimate expectations in nonpurchase-money security interests of the type involved here. Creditors who obtain liens such as these have no interest in actual possession and resale of the property; rather, the threat of repossession pursuant to the lien is used to guarantee payment of the debt or to obtain reaffirmation of the debt in the event of default. Because the lien is no more than a means of collecting on the debtor's personal obligation, the lienholder is entitled to no greater constitutional protection in the event of bankruptcy than is an unsecured creditor.

Nor does Section 522(f)(2) effect a complete taking of the creditor's property interest. Liens remain valid to the extent they attach to non-exempt property. Even if the lien is avoided under Section 522(f)(2), the lienholder retains his right to collect on the debt in the bankruptcy proceeding. Moreover, because the Bankruptcy Reform Act did not become effective until October 1979, all holders of nonpurchase-money security interests were guaranteed a period of time in which they could enjoy the intended use of the lien and seek to try to protect their security against future

avoidance. Finally, creditors clearly have a limited expectation, entitled to minimal protection, in retaining rights obtained by means of what Congress found to be "contract[s] of adhesion" that give them an "unfair advantage." See H.R. Rep. No. 95-595, *supra*, at 127.

## ARGUMENT

### SECTION 522(f)(2) OF THE BANKRUPTCY CODE DOES NOT VIOLATE THE FIFTH AMENDMENT

There can be no doubt that the Constitution does not prohibit Congress from enacting bankruptcy legislation that gives bankrupt debtors the right to retain certain household necessities, for purposes of giving the debtors a reasonable opportunity for a "fresh start" after bankruptcy, even though those household items may be subject to a security interest. Neither the appellees nor the courts below suggest any such prohibition. Rather, the court of appeals held Section 522(f)(2) unconstitutional only to the extent that it has retrospective effect on security interests that were created before its enactment. Section 522(f)(2), of course, is not true "retroactive" legislation, because it is not directed at past events and did not take effect until after its enactment. See Note, *Lien Avoidance Under Section 522(f) of the Bankruptcy Code: Is Retrospective Application Constitutional*, 49 Ford. L. Rev. 615, 620 n.29 (1981) [hereinafter cited as *Lien Avoidance*]. Section 522(f)(2) was enacted on November 6, 1978, and applies only to bankruptcy proceedings commenced after October 1, 1979. See Section 402(a), Pub. L. No. 95-598, 92 Stat. 2682. But when a debtor invokes Section 522(f)(2) to avoid a lien created prior to November 6, 1978, the Act has a retrospective effect in that it affects an obligation established prior to its enactment. It is this limited retro-

spective effect that the court of appeals held to be unconstitutional.

### A. Section 522(f)(2) Satisfies The Due Process Clause Because It Is A Rational Exercise Of The Bankruptcy Power

Although the court of appeals did not specify which clause of the Fifth Amendment it considered violated by Section 522(f)(2), the bankruptcy courts in this case uniformly held that the retrospective application of the statute implicated the protections of the Due Process Clause. See J.S. App. 23a-24a, 29a-30a, 51a, 57a. Analyzing the question here as one of substantive due process accords with the way the Court historically has treated questions of retroactivity, including the retrospective effect of a statute on pre-enactment rights and obligations. See, *e.g.*, *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 14-20 (1976); *FHA* v. *The Darlington Inc.*, 358 U.S. 84, 91-92 (1958); see generally Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 694 (1960). Accordingly, we will turn first to the question whether Section 522(f)(2), as applied to liens created prior to its enactment, violates the Due Process Clause.

#### 1. *Bankruptcy Legislation That Operates Retrospectively Ordinarily Satisfies the Rational Basis Test of the Due Process Clause*

In the early years of this century, congressional legislation was closely scrutinized by the courts under the rubric of "substantive due process." See, *e.g.*, *Lochner* v. *New York*, 198 U.S. 45 (1905). But that approach has "long since been discarded" by this Court (*Ferguson* v. *Skrupa*, 372 U.S. 726, 730 (1963)), and it is now well established that a statute

of general application that regulates economic matters satisfies the Due Process Clause if it has a rational basis. See, *e.g.*, *Williamson* v. *Lee Optical Co.*, 348 U.S. 483, 487-488 (1955); *United States* v. *Carolene Products Co.*, 304 U.S. 144, 152 (1938). The test is no different when the due process challenge to economic regulation is based on a statute's retroactive effect.[5] Even where a question of retroactivity is involved, "legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and * * * the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way." *Usery* v. *Turner Elkhorn Mining Co.*, *supra*, 428 U.S. at 15. The power of government to enact a reasonable remedy for a public ill is not negated "merely because it has some retrospective operation." *Chase Securities Corp.* v. *Donaldson*, 325 U.S. 304, 315 (1945). See also *Blount* v. *Windley*, 95 U.S. 173, 180 (1877); *Curtis* v. *Whitney*, 80 U.S. (13 Wall.) 68, 70-71 (1871).

In particular, the courts have recognized that bankruptcy legislation is constitutional even though it may operate retrospectively on pre-enactment rights. The nature of bankruptcy legislation is such that it ordinarily affects creditor interests that accrued prior to enactment. See, *e.g.*, *Claridge Apartments Co.* v. *Commissioner*, 323 U.S. 141 (1944); *Carpenter* v. *Wabash Ry.*, 309 U.S. 23 (1940); *McFaddin* v. *Evans-Snider-Buel Co.*, 185 U.S. 505 (1902); *Legal*

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[5] Retroactive legislation that benefits the government by reducing its obligations to private parties, however, may be subjected to a stricter standard than general economic legislation. See *Perry* v. *United States*, 294 U.S. 330 (1935); *Lynch* v. *United States*, 292 U.S. 571 (1934); G. Gunther, *Cases and Materials on Constitutional Law* 616 (9th ed. 1975).

*Tender Cases*, 79 U.S. (12 Wall.) 457, 549-550 (1870); *In re Ashe*, No. 81-1629 (3d Cir. Jan. 6, 1982), slip op. 9; *In re Pillow*, 8 Bankr. Rep. 404, 412-413 (D. Utah 1981). See generally C. Warren, *Bankruptcy in United States History* 5-6, 9, 14, 104-105, 111-112, 156-158 (1935).[6] Congress' bankruptcy power necessarily includes "the power to discharge the debtor from his contracts and legal liabilities, * * * [which] involves the power to impair the obligation of contracts." *Hanover National Bank* v. *Moyses*, 186 U.S. 181, 188 (1902). Thus, the Court has stated that contracts are made "subject to constitutional power in the Congress to legislate on the subject of bankruptcies." *Wright* v. *Union Central Life Insurance Co.*, 304 U.S. 502, 516 (1938). See also *In re Prima Co.*, 88 F.2d 785, 788 (7th Cir. 1937) (parties to a contract are charged with knowledge that, if debtor becomes bankrupt, their rights are affected "by existing bankruptcy laws and all future bankruptcy legislation which might be enacted").

Because of the nature of bankruptcy legislation, the Court has repeatedly recognized Congress' broad discretion to enact such legislation despite the constraints of the Fifth Amendment. In *Hanover National Bank* v. *Moyses*, *supra*, the Court explained that "Congress may prescribe any regulations con-

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[6] For this reason, and because of the text of the Bankruptcy Act (see Section 403, Pub. L. No. 95-598, 92 Stat. 2683), the courts and commentators generally have agreed with the court of appeals (Pet. App. 7a-9a) that Section 522(f)(2) does apply to pre-enactment security interests. See Note, *Lien Avoidance*, *supra*, 49 Ford. L. Rev. at 621-626 & nn.32, 33; Note, *Constitutionality of Retroactive Lien Avoidance Under Bankruptcy Code Section 522(f)*, 94 Harv. L. Rev. 1616, 1619 n.20 (1981). But see *In re Gifford*, No. 81-1174 (7th Cir. Jan. 21, 1982).

cerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law." 186 U.S. at 192. And, with one exception (*Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935)),[7] the Court has consistently upheld federal bankruptcy legislation and bankruptcy court decrees against challenges that they impermissibly interfered with creditors' vested rights. See, *e.g.*, *New Haven Inclusion Cases*, 399 U.S. 392, 490-492 (1970); *Wright* v. *Union Central Life Insurance Co.*, 311 U.S. 273 (1940); *Pepper* v. *Litton*, 308 U.S. 295, 312 (1939); *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry.*, 294 U.S. 648, 680-681 (1935); *Hanover National Bank* v. *Moyses*, *supra*. In sum, because the fact that bankruptcy legislation affects pre-existing relationships is "the essence of such legislation" (*In re Ashe*, *supra*, slip op. 9), the retrospective effect of a bankruptcy statute that applies only to future proceedings ordinarily does not implicate due process concerns.

### 2. *Section 522(f)(2) is a Rational Exercise of Congress' Bankruptcy Power*

A major goal of the Bankruptcy Reform Act of 1978 was to "redesign[] traditional bankruptcy protections to make them more effective for non-business debtors." 123 Cong. Rec. 35444 (1977) (statement of Rep. Rodino). Since the previous major revision of the bankruptcy laws in 1938, consumer financing had burgeoned into a major industry, and consumer bankruptcies had come to account for nearly 90% of the bankruptcy cases filed each year. *Ibid.*;

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[7] The *Radford* case is discussed in detail at pages 26-41, *infra*.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 4, 116 (1977). The existing bankruptcy law, however, had been addressed primarily to the problems involved in business bankruptcies. As a consequence, the law "was not designed to provide adequate relief to the consumer debtor," and creditors had been able to "develop[ ] techniques that enable[d] them to avoid the effects of a debtor's bankruptcy." H.R. Rep. No. 95-595, *supra*, at 116-117. The result was that consumer debtors frequently came through bankruptcy "little better off than they were before." *Id.* at 117.[8]

The primary reason that the old bankruptcy law failed to provide meaningful relief to consumer debtors was its reliance on outmoded state exemption laws that allowed the bankrupt debtor to be practically wiped out rather than leaving him with assets ade-

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[8] In 1970 Congress established the Commission on the Bankruptcy Laws of the United States to investigate the need for bankruptcy law reform. Pub. L. No. 91-354, 84 Stat. 468. The Commission's Report (H.R. Doc. No. 93-137 (Pt. I), 93d Cong., 1st Sess. (1973)) and a report prepared by the Brookings Institution (D. Stanley & M. Girth, *Bankruptcy: Problem, Process, Reform* (1971)) both recommended reform of the laws governing consumer bankruptcies. Rep. Edwards, the primary House sponsor of the Bankruptcy Reform Act, explained that both reports had found that:

> [T]he debtor, while he might get a discharge in bankruptcy and be released from his debts, because of loopholes and difficulties with the law, he could find himself with a discharge that was not much good. He still would find after discharge that he owed too much money through nondischargeable debts or debts that he had been forced to reaffirm. Or he did not have enough property for a fresh start—the exemptions provided by the bankruptcy laws were inadequate.

123 Cong. Rec. 35446 (1977).

quate to provide a fresh start after discharge.[9] Finding that "there is a Federal interest in seeing that a debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start" (H.R. Rep. No. 95-595, *supra*, at 126), Congress established a framework to ensure that debtors would not be left completely destitute after bankruptcy. First, Congress provided a system of federal exemptions upon which a debtor might rely as an alternative to less favorable state exemptions. See *id.* at 126-127. More important, however, Congress was aware that the existence of the right to exempt certain property from the bankrupt estate was not alone sufficient to provide a fresh start for the debtor. The Report of the Commission on the Bankruptcy Laws of the United States recognized that valid exemptions often had been lost or denied under prior law. See H.R. Doc. No. 93-137 (Pt. I), 93d Cong., 1st Sess. 169 (1973). In order to make these exemptions effective, the Commission made two complementary recommendations: (1) that

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[9] Specifically, the House Report found:

> Under current law, what property is exempt is determined under State law. However, some State exemption laws have not been revised in this century. Most are outmoded, designed for more rural times, and hopelessly inadequate to serve the needs of and provide a fresh start for modern urban debtors. The historical purpose of these exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge. The purpose has not changed, but neither have the level of exemptions in many States. Thus, the purpose has largely been defeated.

H.R. Rep. No. 95-595, *supra*, at 126 (footnotes omitted). See also 123 Cong. Rec. 35452 (1977).

a waiver of exemptions not be enforceable in the bankruptcy proceeding and (2) that nonpurchase-money security interests in household goods, wearing apparel, and health aids not be enforceable. *Id.* at 169, 170, 173.

Congress acted on both of these recommendations. Section 522(e) of the Bankruptcy Code makes unenforceable a waiver of exemptions. Section 522(f)(2) of the Code permits the bankrupt to avoid a nonpossessory, nonpurchase-money security interest in certain exempt household and personal goods for the purpose of "protect[ing] the debtor's exemptions, his discharge, and thus his fresh start." H.R. Rep. No. 95-595, *supra*, at 362.[10] Nevertheless, Congress did not make this lien avoidance provision applicable to all exempt property. Rather, it limited its applicability to certain household necessities, which in turn are subject to the dollar limitations in Section 522(d), the exemption provision. See 11 U.S.C. (Supp. IV) 522(f)(2); pages 4-5, *supra*.

The House Report explained in detail why Congress deemed the power to avoid nonpossessory, nonpurchase-money security interests in this exempt property to be an integral part of the bankruptcy reform:

> Frequently, creditors lending money to a consumer debtor take a security interest in all of the debtor's belongings, and obtain a waiver by the

[10] Under *Long* v. *Bullard*, 117 U.S. 617 (1886), a lien in exempt property survives the bankruptcy discharge. Congress specifically noted that it was adhering to this rule in the Bankruptcy Reform Act. H.R. Rep. No. 95-595, *supra*, at 361. Thus, under the new Code, except for the narrow category of liens addressed by Section 522(f), liens on both exempt and nonexempt property remain enforceable after the conclusion of the bankruptcy proceeding.

> debtor of his exemptions. In most of these cases, the debtor is unaware of the consequences of the forms he signs. The creditor's experience provides him with a substantial advantage. If the debtor encounters financial difficulty, creditors often use threats of repossession of all of the debtor's household goods as a means of obtaining payment.
>
> In fact, were the creditor to carry through on his threat and foreclose on the property, he would receive little, for household goods have little resale value. They are far more valuable to the creditor in the debtor's hands, for they provide a credible basis for the threat, because the replacement costs of the goods are generally high. Thus, creditors rarely repossess, and debtors, ignorant of the creditors' true intentions, are coerced into payments they simply cannot afford to make.
>
> The exemption provision allows the debtor, after bankruptcy has been filed, and creditor collection techniques have been stayed, to undo the consequences of a contract of adhesion, signed in ignorance, by permitting the invalidation of non-purchase money security interests in household goods. Such security interests have too often been used by over-reaching creditors. The bill eliminates any unfair advantage creditors have.

H.R. Rep. No. 95-595, *supra*, at 127. See also *In re Pillow*, *supra*, 8 Bankr. Rep. at 406.

Thus, Congress found that three different factors warranted the enactment of Section 522(f)(2). First, the existence of "[o]verbroad security interests on all of a consumer's household and personal goods" was one of the major reasons why bankruptcy proceedings did not enable consumer debtors to enjoy a fresh start. H.R. Rep. No. 95-595, *supra*, at 117.

Second, Congress found that permitting avoidance of these liens was not a substantial imposition on creditors because they rarely repossessed these household goods in view of their low resale value; rather, they used the threat of repossession as a means of ensuring payment of the loan while the debtor was able to pay. Finally, Congress found that these nonpurchase-money security interests were a form of overreaching that was the product of a creditor's unfair advantage over the debtor.[11]

In view of these compelling reasons, there can be no doubt that Congress acted rationally in not creating a special exception to Section 522(f)(2) for liens created before its enactment. One of the important considerations in determining the reasonableness of the retroactive aspects of a legislative program is the "strength of the public interest served by the statute." Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 697 (1960). Here, Section 522(f)(2) was

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[11] The statement of David H. Williams, an attorney with the Federal Trade Commission's Bureau of Consumer Protection, made at the House hearings on the Bankruptcy Act revision (see *Hearings on H.R. 31 and H.R. 32 Before the Subcomm. On Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st & 2d Sess., Pt. 2, 758-763 (1975-1976)), was reprinted as an appendix to the House Report. See H.R. Rep. No. 95-595, *supra*, at 166-173. The statement detailed some of the results of an FTC investigation of the consumer finance industry. It stated that "[o]ne of the most important and widely abused devices available to the large credit institution is a blanket security interest in household necessities." *Id.* at 171. These "boilerplate" contracts were presented to borrowers on "a strict, take it or leave it basis" (*id.* at 169) and often "were cast in general form merely applying to every household good of every kind and description." *Id.* at 171.

deemed necessary to safeguard the debtor's exemptions in certain household necessities. Thus it is an essential feature of the Bankruptcy Reform Act's attempt to further what this Court long has recognized as one of the primary purposes of bankruptcy law—giving debtors " 'a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Perez* v. *Campbell*, 402 U.S. 637, 648 (1971), quoting *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244 (1934).[12]

In the absence of Section 522(f)(2), a creditor would retain the right to take from a bankrupt debtor his bed, his table, and even his kitchen utensils, even though the creditor's loan did not contribute to the purchase of those items and even though its legal entitlement to them might be based solely upon a "contract of adhesion signed in ignorance." Because of the high replacement value of these goods, a debtor could not afford to have them taken away and would be effectively compelled to reaffirm debts after the bankruptcy discharge in order to avoid enforcement of the lien. See H.R. Rep. No. 95-595, *supra*, at 163;

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[12] The Court has noted in particular the important function that a system of exemptions serves in furthering this purpose. In *Bronson* v. *Kinzie*, 42 U.S. (1 How.) 311, 315 (1843), the Court held that the special status of household necessities permitted a state to provide in insolvency legislation that such items be exempt from execution on judgments, noting that "[r]egulations of this description have always been considered, in every civilized community, as properly belonging to the remedy, to be exercised or not by every sovereignty, according to its own views of policy and humanity." The items identified by the Court in 1843 as necessities, "necessary implements of agriculture, or the tools of a mechanic, or articles of necessity in household furniture, [or] * * * wearing apparel" (42 U.S. (1 How.) at 315), parallel those items on which Section 522(f)(2) permits lien avoidance.

*In re Pillow*, *supra*, 8 Bankr. Rep. at 406. Thus, his "fresh start" would be saddled with old debt. Congress determined that, as of the effective date of the statute, which was almost a year after its enactment, these liens should no longer be used to prevent a debtor filing for bankruptcy from getting a fresh start. This statutory purpose would have been frustrated if Congress had made a special exception to Section 522(f)(2) for pre-enactment liens. Such an exception would have denied many future bankrupt debtors protection against these unfair and draconian consequences of the liens, and it would have unnecessarily delayed for many years the effectiveness of reforms that were long overdue. Moreover, a bankruptcy proceeding in which different versions of the bankruptcy law apply to different debts, depending upon the date of certain transactions, would be fraught with unnecessary confusion. Under these circumstances, it would have been quite irrational for Congress to deviate in this instance from the general rule that the bankruptcy law applicable in a particular proceeding applies to all of the debts of the bankrupt.

In addition, apart from the fact that the retrospective effect of bankruptcy legislation ordinarily presents no due process problem, the particular features of Section 522(f)(2) make it clear that, even as applied retrospectively, the statute has a rational basis. "The need for retroactivity is particularly compelling in those cases in which the very transaction from which it is claimed a vested right has arisen is one of those which motivated the legislature to act." Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, *supra*, 73 Harv. L. Rev. at 701-702. Here, of course, Section 522(f)(2) is aimed directly at eliminating the harm-

ful effects of contracts that create nonpurchase-money security interests, and thus, under this principle, it unquestionably was appropriate not to make a special exception to exclude existing security interests from the statute's coverage. See *American Power & Light Co.* v. *SEC*, 329 U.S. 90, 106-107 (1946); *North American Co.* v. *SEC*, 327 U.S. 686, 707-710 (1946); *Louisville & Nashville R.R.* v. *Mottley*, 219 U.S. 467, 480-486 (1911). Furthermore, because Congress found that these security interests were created by unfair "contract[s] of adhesion," it would have been perverse to create a special exception to enable creditors to take advantage of such contracts that were already in existence. See, *e.g.*, *McFaddin* v. *Evans-Snider-Buel Co.*, *supra*, 185 U.S. at 511; *Ewell* v. *Daggs*, 108 U.S. 143, 151 (1883); see generally Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, *supra*, 73 Harv. L. Rev. at 720-722. Hence, Congress was confronted with a particularly strong case for curative action to ameliorate the unfairness of such contracts through retrospective application of the statute.

Finally, the constitutionality of Section 522(f)(2), as applied to pre-existing security interests, is supported by an additional important factor: the statute is addressed only to a creditor's *remedy*. While the distinction between a substantive right and a remedy is not always clear-cut, this Court has recognized that the distinction provides a "workable concept" for identifying those situations in which the retroactive aspects of a statute implicate due process concerns. *Chase Securities Corp.* v. *Donaldson*, *supra*, 325 U.S. at 314; *Campbell* v. *Holt*, 115 U.S. 620 (1885). Here, Section 522(f)(2) does not affect the creditor's basic right to collect on the debt; it affects only his par-

ticular remedy of being able to levy on the secured property to satisfy the debt, and then only to the extent that the property is subject to exemption by the debtor. Thus, the retrospective effect of Section 522(f)(2) does not raise a serious due process question.[13]

### B. Section 522(f)(2) Does Not Constitute A Taking Of Property

#### 1. *The* Radford *Case Does Not Suggest that a Taking Necessarily Occurs When Bankruptcy Legislation Substantially Impairs the Value of a Lien*

Rather than focusing on the nearly unbroken chain of decisions upholding bankruptcy legislation that affects pre-existing rights, the court of appeals relied exclusively on the one case that has held a federal bankruptcy statute violative of the Fifth Amendment. In *Louisville Joint Stock Land Bank* v. *Radford*, *supra*, the Court held unconstitutional the Frazier-Lemke Act of 1934. That statute, in order to alleviate the Depression's economic impact on farmers, amended the Bankruptcy Act to permit farmers who defaulted on their mortgages to defeat actions to foreclose on their farms by invoking a five-year foreclosure moratorium and provided for a scaling down of the mortgage indebtedness to the value of the property. Specifically, the Act gave the farmer

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[13] The Ex Post Facto Clauses, Article I, Section 9, Clause 3, and Article I, Section 10, place a specific constitutional prohibition on the federal and state governments respectively with regard to retroactivity in the criminal area. See *Calder* v. *Bull*, 3 U.S. (3 Dall.) 386 (1798). Because they apply to criminal cases, scrutiny of retroactive legislation under the Ex Post Facto Clauses is severe. Even under those clauses, however, the Court has recognized that retroactive legislation concerning procedural, rather than substantive, rights ordinarily does not violate the Constitution. See *Dobbert* v. *Florida*, 432 U.S. 282, 293 (1977).

the right to retain possession of the farm, while paying rent into court for the benefit of both secured and unsecured creditors, and to redeem the farm at its appraised value at any time during the five-year period. The Act explicitly provided, however, that it applied only to debts existing at the time it became effective, not to future mortgages. See 48 Stat. 1289; 295 U.S. at 575-576.

In 1933, the mortgagee Louisville Bank had commenced a suit to foreclose Radford's mortgages because of his default on the installment payments. 295 U.S. at 574. Two days before the state court entered judgment ordering a foreclosure sale, the Frazier-Lemke Act was passed, and Radford subsequently sought relief under the Act. *Id.* at 575. This Court held, however, that the Act was unconstitutional. The Court noted that because a right in specific property was involved, the Act did more than simply discharge Radford's personal obligation, which clearly would have been within Congress' power. *Id.* at 589-590. The Court also emphasized that the Act applied only retroactively. *Id.* at 589, 595. Identifying five different rights in the mortgage that the Act took from the mortgagee (*id.* at 594-595),[14] the Court concluded that the Act as applied deprived the bank without compensation of "rights in specific property which are of substantial value" and hence violated the Fifth Amendment. *Id.* at 601.

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[14] The five mortgagee rights identified by the Court were: (1) the right to retain the lien until the debt was paid; (2) the right to realize upon the security by a judicial sale; (3) the right to determine when the sale would be held; (4) the right to bid at the sale and thus to take the property itself; and (5) the right to control the property during the period of default, including the collection of rents and profits by a receiver. 295 U.S. at 594-595.

The Court quickly retreated from the broad implications of the *Radford* decision. In *Wright* v. *Vinton Branch*, 300 U.S. 440 (1937), it upheld an amended version of the Frazier-Lemke Act, ch. 792, 49 Stat. 942, which provided for a three-year mortgage moratorium and applied to both pending and future cases (see *id.* at 945). Explaining that some of the five rights identified in *Radford* were not infringed by the statute (300 U.S. at 458-468), the Court concluded that the Act was constitutional because it did not modify the secured creditor's rights "to such an extent as to deny the due process of law guaranteed by the Fifth Amendment," because the modifications of the mortgagee's rights were not "unreasonable." 300 U.S. at 470. Commentators have observed, however, that there was no "significant difference" between the two versions of the Frazier-Lemke Act. Countryman, *Real Estate Liens in Business Rehabilitation Cases*, 50 Am. Bankr. L. J. 303, 335 (1976). See also Rosenberg, *Beyond* Yale Express: *Corporate Reorganization and the Secured Creditor's Rights of Reclamation*, 123 U. Pa. L. Rev. 509, 522 n.45 (1975); Note, *Constitutional Limitations on the Bankruptcy Power: Chapter XII Real Property Arrangements*, 52 N.Y.U. L. Rev. 362, 385 (1977); *In re Pillow*, *supra*, 8 Bankr. Rep. at 415. Thus, while the Court distinguished *Radford*, the *Vinton Branch* decision clearly marked a substantial departure from the *Radford* analysis.

Subsequent decisions on questions arising under the second Frazier-Lemke Act further undercut the *Radford* approach. In upholding the statutory provision entitling the defaulting mortgagor to possession of the farm for three years, the *Vinton Branch* decision had stressed that the statute did not appear to prevent the court from intervening before the end of

this period and ordering a sale to protect the creditors' interests if it became clear that the debtor could not rehabilitate himself. 300 U.S. at 460-463 & n.6. However, the Court soon backed away from this construction of the Act, characterizing it as dictum and not supported by the terms of the statute. *John Hancock Insurance Co.* v. *Bartels*, 308 U.S. 180, 184 n.3 (1939). Finally, the Court held in *Wright* v. *Union Central Life Insurance Co.*, 311 U.S. 273 (1940), that even a debtor who failed to pay court-ordered rents had an absolute right to redeem the property at its appraised value and defeat the mortgagee's desire to hold a public sale. Thus, although this Court has never overruled *Radford*, it has eroded its precedential significance substantially. See generally *In re Pillow*, *supra*, 8 Bankr. Rep. at 414-415 n.15. Indeed, the Court candidly acknowledged that fact when it listed *Radford* and *Vinton Branch* as illustrations of a situation where the Court fell into error and required by Congress to re-examine an earlier decision. *Helvering* v. *Griffiths*, 318 U.S. 371, 400-401 n.52 (1943).

The Court's departure from *Radford*, which even the court of appeals acknowledged to some extent (J.S. App. 11a), raises the question whether *Radford* retains any vitality today. The court of appeals suggests that *Radford* still stands for the proposition that a rigid line must be drawn between creditor interests that are classified as contractual and any creditor lien; the Constitution does not forbid impairment of contractual interests, according to the court below, but it does forbid the impairment of liens because they are "property interests" (*id.* at 10a-11a). This simplistic distinction, however, is not reflected in the decisions of this

Court, and it does not comport with the realities of bankruptcy law.

"Property" rights within the meaning of the Fifth Amendment extend to many rights other than traditional property interests such as liens. See, *e.g.*, *Arnett* v. *Kennedy*, 416 U.S. 134, 154-155 (1974); *Goldberg* v. *Kelly*, 397 U.S. 254, 262 (1970) (Fourteenth Amendment). While the meaning of property for procedural due process purposes is perhaps broader than in the context where a taking is alleged, there is no reason why a contractual right is necessarily excluded in the latter context.[15] It is true, of course, that the Constitution does not bar Congress from impairing the obligations of contracts as it does the states. See *Louisville Joint Stock Land Bank* v. *Radford*, *supra*, 295 U.S. at 589. Thus, Congress may be empowered to pass particular debtor relief legislation that is beyond the power of the states. See *In re Ashe*, *supra*, slip op. 9 n.7. But there may well be some overlap between the restraints the Contract Clause places on the states and the restraints the Fifth Amendment places on the federal government; legislation that impairs the obligation of contracts is not necessarily immune from challenge under the Fifth Amendment. For example, a contractual agreement certainly can confer on a party a right of action irrespective of any lien. Yet this Court has assumed that governmental action that effected a "taking" of a cause of action could give rise to a claim for compensation under the Takings Clause. *Dames & Moore* v. *Regan*, No. 80-2078 (July 2, 1981), slip op. 30-31.

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[15] The Court has stated explicitly that valid contracts are property subject to the protections of the Fifth Amendment. *Thorpe* v. *Housing Authority*, 393 U.S. 268, 278 n.31 (1969); *Lynch* v. *United States*, *supra*, 292 U.S. at 579. See also *Norman* v. *Baltimore & O. R.R.*, 294 U.S. 240, 307 (1935).

By the same token, bankruptcy principles do not support a sharp distinction between the rights of secured and unsecured creditors. Even contemporaneous commentary on *Radford*, before its principles were eroded by decisions under the amended Frazier-Lemke Act, recognized that the Court did not intend to establish such a distinction, because "it is difficult to see why the contract of a secured creditor may not be impaired as well as the contract of an unsecured creditor." C. Warren, *Bankruptcy in United States History* 157 (1935). Other bankruptcy scholars have urged that there is no basis for according greater constitutional protection to the property rights of a secured creditor than to those of an unsecured creditor. Countryman, *Treatment of Secured Claims in Chapter Cases*, 82 Com. L. J. 349, 359-360 (1977); Martin, *Substantive Regulation of Security Devices Under the Bankruptcy Power*, 48 Colum. L. Rev. 62, 71-74 (1948). See also *Campbell* v. *Alleghany Corp.*, 75 F.2d 947, 954 (4th Cir.), cert. denied, 296 U.S. 581 (1935). To be sure, secured and unsecured creditors historically have been treated differently in bankruptcy proceedings in that secured creditors may retain a lien in the debtor's property after discharge (see *Long* v. *Bullard*, 117 U.S. 617 (1886)), but that difference in treatment is recognized as "a matter wholly within the discretion of Congress." *First National Bank* v. *Staake*, 202 U.S. 141, 148 (1906).

In sum, while the existence of a lien may be a factor in determining whether a taking has occurred, the court of appeals' suggestion that it is the conclusive factor in the inquiry is unsound. A contractual right may also be entitled to Fifth Amendment protection. In the bankruptcy context, of course, it is well established that the discharge of an unsecured creditor without full payment of the debt does not constitute

a taking. See, *e.g.*, *Hanover National Bank* v. *Moyses*, *supra*, 186 U.S. at 188. But it is also clear that the rights of a secured creditor may be substantially impaired in the exercise of Congress' bankruptcy power. *New Haven Inclusion Cases*, *supra*, 399 U.S. at 490-491. The bankruptcy laws have always contained preference and other provisions that void or subordinate the interests of secured creditors. See, *e.g.*, *American Surety Co.* v. *Sampsell*, 327 U.S. 269 (1946); Countryman, *Real Estate Liens in Business Rehabilitation Cases*, 50 Am. Bankr. L. J. 303, 335 (1976). And this Court has held that the bankruptcy court may invalidate a creditor's lien in specific property—a debtor's future wages—that was valid under state law. *Local Loan Co.* v. *Hunt*, 292 U.S. 234 (1934).

The Court's statement in *Radford* that the bankruptcy power "is subject to the Fifth Amendment" (295 U.S. at 589) is of course equally true today. But the bankruptcy power permits Congress, within reasonable limits, to enact legislation that affects creditors' interests—interests that ordinarily are characterized as property interests. In light of subsequent developments, *Radford* must be treated as limited to its facts on the question of under what circumstances Congress should be deemed to have exceeded those limits. Other decisions of this Court, however, provide guidelines for identifying those unusual cases where "justice and fairness" require that regulation in the public interest be characterized as a taking such that just compensation is due for resulting private economic injuries. See *Penn Central Transportation Co.* v. *New York City*, 438 U.S. 104, 124 (1978). This Court has identified two general factors of particular significance in this inquiry:

"the character of the governmental action" and "[t]he economic impact of the regulation." *Ibid.* An examination of these factors, and of the crucial differences between this case and *Radford*, plainly demonstrates that Section 522(f)(2) does not effect an unconstitutional taking.[16]

### 2. *The Character of the Government Action Here Does Not Indicate a Taking*

This Court has stated that government action is more vulnerable to constitutional attack as a taking if it "can be characterized as a physical invasion by government" or as an acquisition of property by the government for its own use. See *Penn Central Transportation Co.* v. *New York City*, *supra*, 438 U.S. at 124, 135. On the other hand, a taking ordinarily should not be found where the interference "arises

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[16] The *Radford* decision has been the source of a great deal of confusion as to whether it relies upon the Due Process Clause or the Takings Clause. See, *e.g.*, *In re Ashe*, *supra*, slip op. 11-12. Although the conclusion of *Radford* seems to focus on the Takings Clause (295 U.S. at 601-602), its progeny, including an opinion by the same author, have characterized it as a due process case. See *Wright* v. *Union Central Life Insurance Co.*, *supra*, 304 U.S. at 515 & n.17, 517-518 & n.23; *Wright* v. *Vinton Branch*, *supra*, 300 U.S. at 470. Accordingly, the bankruptcy courts in this case (see J.S. App. 23a-24a, 29a & n.3, 51a, 57a) and some commentators (see Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 694 n.15 (1960)) have treated *Radford* as an interpretation of the Due Process Clause.

The language of *Radford* and that of the court of appeals (J.S. App. 10a), however, seem to focus on the Takings Clause. Moreover, this Court's most recent citation to *Radford* also treated it as construing the Takings Clause. *Armstrong* v. *United States*, 364 U.S. 40, 44 (1960). Accordingly, we will discuss its applicability here in terms of that clause.

from some public program adjusting the benefits and burdens of economic life to promote the common good." *Id.* at 124. Cf. *Usery* v. *Turner Elkhorn Mining Co.*, *supra*, 428 U.S. at 15. This is because government regulation, by definition, involves the adjustment of rights for the public good; to require the government to compensate private parties for each regulatory interference would require it to "regulate by *purchase*." *Andrus* v. *Allard*, 444 U.S. 51, 65 (1979) (emphasis in original).

This case involves a classic example of government regulation for the common good of the sort that ordinarily raises no serious constitutional question. Section 522(f)(2) is neutral bankruptcy legislation of general applicability, which is made effective only in future bankruptcy proceedings. Indeed, its enactment in November 1978 had no effect at all on any existing liens except in the event that a debtor with property still subject to the type of lien covered by Section 522(f)(2) filed for bankruptcy after October 1, 1979—a retrospective effect common to almost all bankruptcy legislation. Moreover, Section 522(f)(2) is an integral part of a legislative scheme specifically directed at safeguarding a debtor's exemptions in necessities in order to enable him to start anew after bankruptcy, which this Court has repeatedly recognized as one of the primary purposes of federal bankruptcy legislation. *Perez* v. *Campbell*, *supra*, 402 U.S. at 648; *Lines* v. *Frederick*, 400 U.S. 18, 19 (1970); *Local Loan Co.* v. *Hunt*, *supra*, 292 U.S. at 244. See also *Bronson* v. *Kinzie*, 42 U.S. (1 How.) 311, 315 (1843). And the Court has noted approvingly that "[w]here the minimal requirements for the economic survival of the debtor are at stake, legislatures have recognized that protection that might

be unnecessary or unwise for other kinds of property may be required." *Lines* v. *Frederick*, *supra*, 400 U.S. at 20.[17]

Thus, Section 522(f)(2) stands in sharp contrast to the Frazier-Lemke Act of 1934 invalidated by this Court in *Radford*. First, the *Radford* Court pointedly noted that there was no contention there that the mortgaged property was exempt as a homestead (295 U.S. at 577); thus, the special provisions of the Act did not safeguard property that was recognized as essential to a debtor's fresh start. Moreover, the Frazier-Lemke Act of 1934 was not ordinary neutral bankruptcy legislation. The Court stated (*id.* at 594): "The controlling purpose of the Act is to preserve to the mortgagor the ownership and enjoyment of the farm property. It does not seek primarily a discharge of all personal obligations—a function with which alone bankruptcy acts have heretofore dealt."

In fact, the Frazier-Lemke Act was quite extraordinary in that it did not apply prospectively at all, but rather *only* affected already existing mortgages. Compare *Bronson* v. *Kinzie*, *supra*, 42 U.S. (1 How.) at 320 (mortgage foreclosure law objectionable because it operated primarily on existing mortgages). Thus, as the Court in *Radford* stressed (295 U.S. at 582), the statute went considerably beyond the long established and clearly appropriate goal of bankruptcy legislation of giving the debtor a fresh start. Rather, because farmers would remain free to secure

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[17] Where the reason for the government action is sufficiently compelling, even an action of the type that most strongly indicates a taking—the physical destruction of selected property—will not be categorized as a taking that requires just compensation under the Fifth Amendment. See, *e.g.*, *United States* v. *Caltex, Inc.*, 344 U.S. 149 (1952); *Miller* v. *Schoene*, 276 U.S. 272 (1928). Such an action, of course, is quite different from the general legislation involved here.

mortgages in the future that were not subject to the constraints of the Frazier-Lemke Act, the Act essentially "had undertaken to supply [the farmer] capital with which to engage in business in the future." *Ibid.*[18] Indeed, because of this exclusively retroactive feature of the statute, the *Radford* Court stated that "we have no occasion to decide in this case whether the bankruptcy clause confers upon Congress generally the power to abridge the mortgagee's rights in specific property." *Id.* at 589.

### 3. *The Economic Impact of Section 522(f)(2) Does Not Indicate That it is a Taking*

a. *A Nonpossessory, Nonpurchase-Money Security Interest Is Not a Substantial Property Interest.* An assessment of the economic impact of a government action necessarily begins with an examination of the property interest that allegedly has been "taken." In *Radford*, the Court focused on this factor in concluding that the Frazier-Lemke Act had taken without compensation "rights in specific property which are of substantial value." 295 U.S. at 601. The nature of the property interest involved here, however—a nonpossessory, nonpurchase-money security interest in household goods—is insubstantial by comparison; it is entitled to little more protection than the property interest a general creditor has in his right to resort to the property of the debtor to satisfy his claim. See C. Warren, *Bankruptcy in United States History* 157 (1935); Countryman, *Real Estate Liens in Business Rehabilitation Cases*, 50 Am. Bankr. L. J. 303, 335-336 (1976).

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[18] The Court explained that the legislative history indicated that Congress had declined to make the Act prospective specifically in order to preserve the farmer's ability to obtain capital in the future. 295 U.S. at 595-596 n.27.

The typical taking occurs when the government obtains the fee simple of a landowner's property pursuant to its eminent domain power. See, *e.g.*, *Berman* v. *Parker*, 348 U.S. 26 (1954). This Court has recognized that other forms of government action may constitute a taking, but these actions generally have involved a substantial interference with an interest in *real* property. This was certainly the case in *Radford*. The Court there discussed the history of real estate mortgages, which had originated not as a lien but as a conveyance upon condition under which the land automatically reverted to the mortgagee upon default. Nothing in the Court's opinion indicates that a non-purchase-money security interest in personal property would be entitled to the same level of constitutional protection. See 295 U.S. at 578-579. Moreover, apart from *Radford*, we are aware of only one other case that has held a government action to be a taking where the property interfered with was not in the possession of the complaining party. Here, of course, neither of these conditions is satisfied; Section 522(f)(2) applies only to nonpossessory liens in personal property.

The one exception to these general characteristics of takings is *Armstrong* v. *United States*, 364 U.S. 40 (1960). In *Armstrong*, a shipbuilder defaulted on its contract with the United States, and pursuant to the contract the government took possession of the unfinished work. The builder's suppliers had retained materialmen's liens in the materials they supplied to the builder, which gave them the right to resort to those materials and unfinished work incorporating them for satisfaction of claims against the builder. The suppliers contended that the government's action was a taking of their property interest in the ma-

terials they had supplied, and this Court agreed.[19] *Armstrong*, however, plainly has no relevance to this case. It did not involve the "consequential incidence" of a general economic regulation; rather, as the Court strongly emphasized, it involved a conversion of property for the government's own use in one particular commercial situation. 364 U.S. at 48-49. This Court has often recognized the general principle that a taking is more readily found when the government itself, rather than the public, is the direct beneficiary of the challenged government action. See *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 163 (1980); *Penn Central Transportation Co.* v. *New York City*, *supra*, 438 U.S. at 135; *United States* v. *Causby*, 328 U.S. 256, 262-263 n.7. See also Sax, *Takings and the Police Power*, 74 Yale L. J. 36, 62-63 (1964). Moreover, the lien in *Armstrong* was of a significantly different and stronger character than those involved here. Because it arose as a result of the sale of the property in question by the lienholders, it was effectively a purchase-money security interest that would not be subject to the narrowly-defined provisions of Section 522(f)(2).

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[19] Because the government had a paramount lien on the unfinished work to secure its progress payments, the Court did not hold that the suppliers necessarily were entitled to compensation for the full value of their claims against the builder. The Court held, however, that there would be a taking to the extent the value of the property exceeded the amount of the progress payments made by the government. 364 U.S. at 44-45. On remand, the Court of Claims found that the value of the property was adequate to satisfy the claims of the suppliers even after the amount of the government's progress payments was deducted. *Armstrong* v. *United States*, 287 F.2d 577 (1961).

Thus, the two cases relied on by the court of appeals, the only ones in which this Court has characterized governmental action impairing a nonpossessory property interest such as a lien as a taking requiring just compensation, are cases in which both the character of the government action and the nature of the property interest were quite different from those involved here.[20] The government action was not a generally applicable statute regulating bankruptcy proceedings, but rather, in *Armstrong*, an acquisition of property by the government as entrepreneur and, in *Radford*, a one-time, retroactive only, relief measure for farmers to "supply [them] capital with which to engage in business in the future" (295 U.S. at 582). The liens in both *Armstrong* and *Radford* were stronger property interests than those involved here because of the clear connection between the property and the debt secured thereby. Where the secured property has been directly benefited, or acquired as a result of, the loan, the creditor clearly has a stronger claim to the property when the debtor defaults on the loan than he does in the case of a nonpurchase-money security interest. See *In re Gifford*, No. 81-1174 (7th Cir. Jan. 21, 1982), slip op. 22 (Cummings, C.J., dissenting).

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[20] In the *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 154-155 (1974), the Court recognized that Congress' statutory reorganization of the Northeast railroads could conceivably result in a taking from the secured creditors. The Rail Act, however, unlike Section 522(f)(2), was not concerned with a debtor's retention of assets as part of a discharge in bankruptcy. Rather, the assets in question were physically expropriated by the government. Thus, Congress itself recognized that the Act effected a taking requiring just compensation; the litigation concerned whether the compensation provided by Congress was adequate. See 419 U.S. at 127-128, 148.

In addition to these inherent differences between a purchase-money security interest and those security interests covered by Section 522(f)(2), Congress made specific findings that confirm that the security interests involved here lack the "substantial value" that the *Radford* Court recognized in real estate mortgages.[21] Congress found that the value of the property secured by nonpossessory, nonpurchase-money liens is essentially de minimis; household goods have "little resale value" and accordingly are only rarely repossessed by creditors. H.R. Rep. No. 95-595, *supra*, at 127; see also *id.* at 171-172 (statement of David H. Williams). In addition, the liens involved here fail to satisfy the second prong of the *Radford* description because, unlike real estate mortgages, they are not interests in "specific property." The liens covered by Section 522(f)(2) ordinarily are "blanket" liens that do not attach to any particular items, but instead cover all of the debtor's household goods. See *id.* at 127; *id.* at 171 (statement of David H. Williams). For example, in the *Rodrock* and *Knezel* cases, it was stipulated that the collateral for the loans involved consisted of every household item owned by the debtors (J.S. App. 17a n.2). Because of these factors, the nonpurchase-money security interests covered by Section 522(f)(2) present "a special case" (H.R. Rep. No. 95-595, *supra*, at 172 (statement of David H. Williams))

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[21] The one specific factor that the Court identified in *Radford* as demonstrating the substantial value of the mortgage rights involved there plainly is absent here. The Court noted as evidence of the substantial impairment of the security interest Congress' unwillingness to make the Frazier-Lemke Act apply prospectively because of its fear that farmers' sources of capital would dry up. 295 U.S. at 595. Here, of course, Section 522(f)(2) is designed to apply in all bankruptcy proceedings commenced after October 1, 1979.

warranting lien avoidance in bankruptcy, and the *Radford* decision pertaining to "rights in specific property which are of substantial value" is not to the contrary.

b. *Section 522(f)(2) Does Not Substantially Interfere With Creditors' Legitimate Expectations in the Secured Property.* In assessing the degree to which Section 522(f)(2) interferes with the legitimate expectations of secured creditors such as appellees (see *Penn Central Transportation Co.* v. *New York City*, *supra*, 438 U.S. at 124), the significance of the congressional findings is not merely that the value of the secured property to the creditor is de minimis (see, *e.g.*, Note, *Lien Avoidance*, *supra*, 49 Ford. L. Rev. at 635-636 & n.123), but also, and even more important, that the creditor has no interest whatsoever in possession of the household goods. Ordinarily, the fact that property is accepted as security for a debt represents the creditor's assessment of the value of the property and his recognition of the possibility that he will have to take the property to satisfy the debt in the event of default. See, *e.g.*, *In re Carter*, 56 F. Supp. 385, 393 (W.D. Va. 1944); *In re Ambrose*, 4 Bankr. Rep. 395, 399 (N.D. Ohio 1980). Such is not the case here. The market value of the property secured by a nonpossessory nonpurchase-money lien is generally far less than the amount of the debt; indeed, as noted above, the resale value of the property is often negligible.[22] On the other hand, the replacement value of

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[22] In contrast to the ordinary situation in the case of a purchase-money security interest, the value of the collateral is not an important factor in determining the amount of credit that a consumer finance company is willing to lend subject to a security interest in household goods. The creditor determines the amount of credit it is willing to extend based on an

such items is generally high, especially to a debtor experiencing financial difficulties. Hence, the creditor's sole interest in the secured property is for use as a threat by which to compel repayment of the debt. In the absence of Section 522(f)(2), the creditor would not use the secured property to satisfy the debt; rather, it would retain the lien to exert leverage to force reaffirmation of the debt after the bankruptcy discharge. See *In re Pillow*, *supra*, 8 Bankr. Rep. at 419.[23]

This view of the purpose of these blanket liens in household goods was conveyed to Congress by creditor representatives as well as witnesses interested in increasing protections for the consumer debtor. The spokesman for the consumer finance companies' trade association testified that secured household goods were of value to the creditor not because of their negligible resale value but because of their great "psychological value." *Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 651 (1977) (statement of Alvin O. Weise, Jr., on behalf of the National Consumer Finance Association). In response to questioning, he acknowledged that, in the event of bankruptcy, creditors do not take possession of household necessities subject to these security interests, but instead use the exist-

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assessment of the consumer's net cash flow position. See H.R. Rep. No. 95-595, *supra*, at 168 (statement of David H. Williams).

[23] In one case where the creditor actually took possession of the household goods, it made no effort to realize any value from the goods and simply discarded them at a junkyard. *In re Curry*, 5 Bankr. Rep. 282, 290 (N.D. Ohio 1980). See also *In re Ambrose*, *supra*, 4 Bankr. Rep. at 400.

ence of the lien to bargain for reaffirmation of the debt. *Id.* at 659. See also H.R. Rep. No. 95-595, *supra*, at 170, 172 (statement of David H. Williams).

Thus, it is quite misleading to treat the lien in this situation as disconnected from the underlying debt. Cf. *Buffum* v. *Peter Barceloux Co.*, 289 U.S. 227, 233 (1933). The lien does not represent any genuine interest in potential possession of the property; it is simply a means of enforcing the debt. When the creditor never has any intention to take possession of the secured property, legislation that permits a bankrupt debtor to defeat the creditor's right to possess that property can hardly be said to be a significant interference with the creditor's expectations. See *In re Gifford*, *supra*, slip op. 23-27 (Cummings, C.J., dissenting). See also Gordon, *Unconscionability in Bankruptcy: The Federal Contribution to Commercial Decency*, 66 Nw. L. Rev. 741, 765 (1972). The creditor's expectation, based on its analysis of the debtor's income prospects, is that the debtor will pay his debt in a timely fashion. When this analysis proves faulty, and the debtor is adjudged a bankrupt, secured creditors such as appellees have no constitutionally protected expectation that the debtor's personal obligation will survive the bankruptcy discharge. See *In re Gifford*, *supra*, slip op. 24-25 (Cummings, C.J., dissenting).

A lien has no talismanic status as a property interest; it is a property interest only to the extent that it allows the creditor to satisfy the debt through seizure of the property. See *In re 620 Church St. Building Corp.*, 299 U.S. 24, 27 (1936) (lien that has no value because it is subordinated to mortgage that exceeds value of property is not entitled to Fifth Amendment protection). Here, of course, the lien is not completely valueless, but its monetary value is so

small that as a practical matter the secured property will not be used to satisfy the debt. Because the only practical value of the lien is as a means of enforcing the debtor's personal obligation, there is no reason why the lienholder should be entitled to greater constitutional protection than an unsecured creditor in collecting on that obligation in the event of bankruptcy. Indeed, affording the holder of a nonpossessory, nonpurchase-money security interest additional protection undermines the important bankruptcy policy of promoting equality among creditors. See *First National Bank* v. *Staake, supra*, 202 U.S. at 149.

Viewed in this light, it is clear that the court of appeals' statement (J.S. App. 10a) that Section 522 (f) (2) effects "a complete taking of the secured creditors' property interests" is incorrect. First, the enactment of Section 522(f) (2) had no effect at all on the liens prior to the filing of a petition for bankruptcy. During this period appellees enjoyed the full intended use of their liens on household necessities as a threat to ensure continuing payments on their loans by the debtor—to the possible exclusion of other creditors. Furthermore, even when a bankruptcy petition was filed, the liens were not totally destroyed. They remained valid as under prior law to the extent they covered items other than the household necessities specified in Section 522(f) (2), and, even with respect to the specified necessities, they remained valid to the extent the value of the items exceeded the dollar limitation contained in the statute. Moreover, even after the Section 522(f) (2) lien avoidance, appellees retained the right to have the non-exempt assets of the estate applied to satisfy their debt. Finally, it is significant in this connection that the Bankruptcy Reform Act was made applicable only to bankruptcy

proceedings commenced after October 1, 1979. Thus, all creditors had an eleven-month period in which they were on notice that nonpossessory, nonpurchase-money security interests would be avoidable in future bankruptcy proceedings. They could have acted to try to protect their security interest during this period by judicial action in the event of default or by negotiating to obtain a lien on non-exempt property. Cf. *Texaco, Inc.* v. *Short*, No. 80-965 (Jan. 12, 1982), slip op. 14 (statute does not effect a taking because plaintiff failed to take advantage of opportunity to take action that would have prevented loss). See generally Note, *Lien Avoidance*, *supra*, 49 Ford. L. Rev. at 634-635 & n.116.

The findings by Congress concerning the nature of these nonpurchase-money security interests further supports the conclusion that Section 522(f)(2) does not constitute such a severe interference with appellees' legitimate expectations that it should be considered a taking. Congress characterized these liens as the result of "contract[s] of adhesion" often obtained by "overreaching creditors." H.R. Rep. 95-595, *supra*, at 127. Clearly, a creditor has a diminished expectation, and one less worthy of protection, in a right secured by a contract that gives him an "unfair advantage" (*ibid.*). See Gordon, *Unconscionability in Bankruptcy: The Federal Contribution to Commercial Decency*, *supra*, 66 Nw. L. Rev. at 765. See also *Williams* v. *Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) (unconscionable contract is unenforceable).[24] In *Gelfert* v. *National City Bank*,

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[24] Section 5.108 of the Uniform Consumer Credit Code (1971), which has been adopted by both Colorado and Kansas (see Colo. Rev. Stat. §§ 5-1-101 *et seq.* (1973); Kan. Stat. Ann. §§ 16a-1-101 *et seq.* (1974)), provides that a court may refuse

313 U.S. 221 (1941), for example, this Court upheld the retrospective application of a state statute that determined the amount of a deficiency judgment after a foreclosure sale. Although the mortgagee received less under the new statute than he would have under the law at the time he entered into the mortgage agreement, the Court rejected a constitutional challenge under the Contract Clause, explaining that the statutory change eliminated an unfair advantage to which the mortgagee had no constitutionally protected right. *Id.* at 234. And, of course, it is well established that the bankruptcy court may invalidate an unfair lien under its power to do equity. *Pepper* v. *Litton*, *supra*, 308 U.S. at 305-312. See also *Local Loan Co.* v. *Hunt*, *supra*, 292 U.S. at 244-245.

4. *Summary*

Although the courts are divided, many bankruptcy courts have concluded that, because of the special nature of the security interests involved here, Section 522(f)(2) does not take the property of creditors without compensation. See, *e.g.*, *In re Morris*, 12 Bankr. Rep. 321 (N.D. Ill. 1981); *In re Pillow*, *supra*; *In re Ambrose*, *supra*; see generally cases cited at J.S. 8-9 n.5. Two courts of appeals have considered the constitutionality of Section 522(f) since the decision of the court of appeals below. In *In re Ashe*, *supra*, the Third Circuit upheld the constitutionality of the retrospective application of Section 522(f)(1), which concerns the avoidance of judicial liens, drawing no distinction in its analysis between the two different types of liens covered by Section 522(f).

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enforcement of an unconscionable agreement, and the official comment to the U.C.C.C. indicates that the "one-sided[ness]" of a transaction is the test of its unconscionability.

The court flatly rejected the applicability of *Radford* to Section 522(f) (slip op. 11-12), and it explicitly "decline[d] to follow" the decision of the court of appeals in this case (slip op. 11 n.8).[25] The Seventh Circuit, in *In re Gifford, supra,* held by a 2-1 vote that Section 522(f)(2) should be read to apply only to security interests created after its enactment. Chief Judge Cummings dissented from this statutory construction and also concluded that the retrospective application of Section 522(f)(2) is constitutional.[26] Commentators, both before and after the decision of the court of appeals below, have rejected its conclusion

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[25] Footnote 8 of the court's opinion was omitted from the slip opinion. It is contained in an order amending the opinion dated January 26, 1982.

[26] Chief Judge Cummings specifically noted the important differences that have been recognized by several bankruptcy courts between the nature of the security interest involved here and the real estate mortgage involved in *Radford*. These courts have recognized:

> (1) there is no direct relationship between the value of the household goods taken as collateral for the consumer loan and the amount of the loan as exists * * * in a mortgage of real estate; (2) the value of the household goods is often nominal whereas realty has a measurable value comparable to the amount of the loan secured; and (3) the lender making small consumer loans, unlike a mortgagee, does not view a security interest in household goods as a potential substitute for the debt. * * * [S]ince the household goods given as security have little or no actual monetary value to the creditor, whatever property interest the creditor has in the collateral does not rise to the level of a mortgagee's property rights in realty.

*In re Gifford, supra,* slip op. 23, quoting *Matter of Ward,* 14 Bankr. Rep. 549, 561 (D.C. S.D. Ga. 1981).

of unconstitutionality. See Note, *Lien Avoidance, supra;* Note, 27 Wayne L. Rev. 1281 (1981); but see Note, *Constitutionality of Retroactive Lien Avoidance Under Bankruptcy Code Section 522(f)*, 94 Harv. L. Rev. 1616 (1981). As explained above, it is our view that the sound basis for this neutral bankruptcy legislation and the extremely weak nature of the security interest involved compel the conclusion that retrospective application of Section 522(f)(2) is constitutional.[27]

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[27] If the Court rejects this view and concludes that Section 522(f)(2) constitutes a taking as applied retrospectively, the *Regional Rail Reorganization Act Cases*, *supra*, 419 U.S. at 125-126, could be read to suggest that affected creditors may bring suit under the Tucker Act to collect just compensation. See Note, *Lien Avoidance*, *supra*, 49 Ford. L. Rev. at 638-639. This conclusion is unwarranted. While the existence of a Tucker Act remedy was correctly presumed in the *Rail Act Cases*, there can be no doubt here that Congress, in enacting a nationwide bankruptcy reform, had no intention of paying compensation to every affected creditor, particularly where Congress had characterized the security interests involved as "contract[s] of adhesion." H.R. Rep. No. 95-595, *supra*, at 127. Clearly, the existence of a Tucker Act remedy cannot be presumed in these circumstances. See Note, *Constitutionality of Retroactive Lien Avoidance Under Bankruptcy Code Section 522(f)*, 94 Harv. L. Rev. 1616, 1631 n.98 (1981); Note, *Constitutional Limitations on the Bankruptcy Power: Chapter XII Real Property Arrangements*, 52 N.Y.U. L. Rev. 362, 401 (1977). Thus, given its apparent finding that retrospective application of Section 522(f)(2) effects a taking, the court of appeals, like the Court in *Radford*, acted correctly in invalidating this retrospective application, rather than holding that creditors have a remedy under the Tucker Act for just compensation.

## CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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# Appellee's Brief

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No. 81-184

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1981

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UNITED STATES OF AMERICA, *Appellant*

v.

SECURITY INDUSTRIAL BANK, *et al.*

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## ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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## BRIEF OF APPELLEES SECURITY INDUSTRIAL BANK AND LIBERTY LOAN CORPORATION

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IN THE

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OCTOBER TERM, 1981

UNITED STATES OF AMERICA,
*Appellant,*

v.

SECURITY INDUSTRIAL BANK, *et al.*
*Appellees.*

BRIEF OF APPELLEES
No. 81-184

## STATEMENT OF THE CASE

The Bankruptcy Reform Act was enacted into law on November 6, 1978. One provision of that law 11 U.S.C. §522(f) provided that certain liens which impaired exemptions could be voided to the extent of the exemption. A full restatement of the applicable provision is in the Solicitors Jurisdictional Statement and the cases appealed which are an appendix thereto.

Security Industrial Bank and Liberty Loan Corporation were the subject of Complaints to Void Liens under §522(f) in the United States Bankruptcy Court for the District of Colorado. In each case the Appellees filed a Motion to Dismiss on the grounds that the voiding of their preenactment security interest in household goods would be a violation of the Fifth Amendment of the United States Constitution citing *Louisville Joint Stock Land Bank vs. Radford*, 295 U.S. (1935).

The United States intervened to defend the constitutional question after receiving notice under 28 U.S.C. 2403(a). The decisions rendered by the Bankruptcy Court were: *Rodrock vs. Security Industrial Bank* and *Knezel vs. Security Industrial Bank* (Appendix C of the Jurisdictional

Statement); *Hoops vs. Freedom Finance and Security Industrial Bank* (Appendix D of the Jurisdictional Statement); *Jackson vs. Security Industrial Bank* and *Stevens vs. Liberty Loan Corp.* (Appendix E of the Jurisdictional Statement).

All four Bankruptcy Judges for Colorado found that Congress intended §522(f) to be applied retrospectively but that when applied to security interests perfected prior to the enactment of the Bankruptcy Code it was unconstitutional under the Fifth Amendment citing *Radford* supra.

At about the same time, *Schulte vs. Beneficial Finance* and *Hunter v. Beneficial Finance* were decided by the Bankruptcy Court for the District of Kansas. That Court found that §522(f) was to be applied prospectively only because of the constitutional problem when it is applied retroactively. (Appendix F of the Jurisdictional Statement).

The Colorado and Kansas decisions were, by Stipulation between the parties, directly appealed to the United States Court of Appeals for the Tenth Circuit pursuant to 28 U.S.C. §1293(b) (made applicable by §405(c) of the Bankruptcy Reform Act) and consolidated. The Tenth Circuit adopted the decisions of the Colorado Bankruptcy Judges, ruling that §522(f) was intended to be applied retrospectively and that when so applied it violated the Fifth Amendment relying again on *Radford.*

The matter is before this Court pursuant to 28 U.S.C. 1252.

## INTRODUCTION AND SUMMARY OF ARGUMENT

The Appellees contend that the Fifth Amendment's Due Process Clause specifically limits the bankruptcy power of Congress and clearly prohibits the retrospective

application of Section 522(f)(2) of the Bankruptcy Code to security interests obtained prior to the enactment date, November 6, 1978, of the new Code.

The Appellees contend that the proper due process standard to be applied to the appeals at bar is the specific one found in *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), and not the general due process standard of a rational basis.

Lastly, the Appellees contend that the congressional fact finding which purportedly affords a rational basis for the retrospective application of Section 522(f)(2) is in effect the creation of a constitutionally impermissible irrebuttable presumption.

## ARGUMENT

### I. A RATIONAL BASIS TEST IS INAPPLICABLE WHERE THERE IS A SPECIFIC STANDARD FOR DUE PROCESS

The Government contends that the constitutionallly of the retrospective application of Section 522(f)(2) of the Bankruptcy Code to security interests obtained prior to the enactment date of the new Code should be tested by the rational basis test of *Hanover National Bank v. Moyses*, 186 U.S. 181, 192 (1901).

For two reasons, the Appellees contend that this Court should not use this general due process standard in deciding whether the Fifth Amendment's Due Process Clause prohibits this retrospective application of Section 522(f)(2). One, this general due process standard relates to discharges in bankruptcy, a concept not involved in this appeal. Two, this Court has provided a specific due process standard for constitutional tests of this sort.

This Court in *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935) (hereinafter cited as *Radford*), has provided the appropriate due process standard to be used for this test.

In fact, there is only one seemingly material difference between *Radford* and the appeal at bar. That is, in *Radford*, the creditor took a security interest in real property, while the Appellees took security interests in personal property. However, this Court in *Armstrong v. United States*, 364 U.S. 40 (1960) (hereinafter cited as *Armstrong*), held that, for due process purposes, there is no material difference between a lien in real property and a lien in personal property:

> No reason has been suggested why the nature of the Liens held by petitioners should be regarded as any different, *for this purpose*, from the interest of the bank held compensable in the *Radford* case.

*Id.* at 44 (emphasis added). And, to further equate these property interests for due process purposes, this Court, in *Armstrong*, characterized liens on personal property as a creditor's property right to resort to specific property for the satisfaction of its claims. *Id.* at 44. This Court, also in *Armstrong*, held that such liens on property rights were within the Fifth Amendment's Due Process Clause protections. *Id.* at 46.

Also, Congress, in enacting the Bankruptcy Code, paralleled this Court's reasoning in *Armstrong* and equated security interests in personal property with security interests in real property. "Lien" is defined in the Bankruptcy Code as "[c]harge against or interest in property to secure payment of a debt or performance of an obligation," 11 U.S.C. 101(28). Security interests are intended to be in-

cluded in this definition. H.R. No. 95-595, 95th Cong. 1st Sess. (1977), p. 312 and S. Rep. No. 95-989, 95th Cong, 2d Sess. (1978), p. 25. In fact, the term "security interest" has a broad usage in the Bankruptcy Code; one that embraces real property mortgages as well as liens in personal property.

Consequently, as this Court has equated property interests in personal property with property interests in real property, for due purposes *Radford*, plus *Armstrong*, and the Code itself furnish this Court with the proper due process standard to be applied to the appeal at bar.

The *Armstrong* Court's use of the phrase "total destruction" in its statement:

> The total destruction by the Government of *all value* of these liens, which constitute compensable property, has every possible element of a Fifth Amendment "taking" . . . .

*Id.* at 48 (emphasis added), is equally important to the appeal at bar because Section 522(f)(2) will work a "total destruction" of all value of the Appellees' liens if allowed to apply to them. *See,* Judge Moore's Memorandum Opinion, 80 M 0014, at page 2 ("If the Plaintiffs [Debtors] succeed, these [pre-enactment security] interests could be of no value . . . ."), p. 2, f.n. 2; Judges McGrath's and Clark's Findings, Conclusions and Order, 80 Mc 0056, at page 7 ("In the instant case, since no item of household goods exceeds $200.00 in value, the liens could be avoided in their entirety. The liens would not be preserved." Judge Moore's opinion also lays to rest the Government's *de minimis* value argument. In both the *Rodrock* and the *Kuezel* case, the household items subject to the liens of the appellees exceeded $500.00 in value. *See,* Judge Moore's Memorandum Opinion, 80 M 0014, at page 2, n 2. The

Appellees can find no decision of this Court that holds that $500.00 liens are not entitled to as great a degree of constitutional protection as liens of a greater amount. Further, Section 522(f)(2), if applied retroactively to pre-enactment security interests, could destroy extremely valuable (in a monetary sense) property interests. After all, theoretically, a debtor could have encumbered an infinite number of household goods worth $200.00 each as security for his loan, and, pursuant to Section 522(f)(2), the debtor could completely destroy the liens. Moreover, when courts begin to make decisions affecting constitutional rights on the basis of mathematical calculations, then, indeed, we shall not all be equal under the law. What is key here is that these liens are valuable and that these liens have a right to Fifth Amendment protection.

Consequently, unless this Court is prepared to overrule *Radford*, this Court must concede the simple and concise argument of the Appellees:

1. *Radford* is "on all fours" with the appeal at bar with the previously noted exception that it involves security interests in real property; and,

2. *Armstrong*, and Congress in enacting the Code, make it clear that there is no difference, for these purposes, between security interests in personal property and security intrests in real property.

*Radford* is clearly "on all fours" with the appeal at bar, and, as such, it speaks specifically and clearly to the issue being appealed.

*Radford* reaffirms that the bankruptcy power of Congress is a limited power:

> The bankruptcy power, like other great substantive powers of Congress, is subject to the Fifth Amendment.

*Id.* at 589. In reaffirming the Fifth Amendment limitation on the bankruptcy power in *Radford*, this Court delineated one specific due process limitation on the bankruptcy power. That is, that Congress may not act to destroy completely the following five substantive rights in specific property acquired prior to the congressional action:

> 1. The right to retain the lien until the indebtedness thereby secured is paid.
>
> 2. The right to realize upon the security by a judicial public sale.
>
> 3. The right to determine when such sale shall be held, subject only to the discretion of the Court.
>
> 4. The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.
>
> 5. The right to control meanwhile the property during the period of default, subject only to the discretion of the Court, and to have rents and profits collected by a receiver for the satisfaction of the debt.

*Id.* at 594-595. Further, the *Radford* Court recognized the important difference between Congress' acting to discharge a debtor's personal obligation and Congress' "taking of substantive rights acquired in specific property acquired by the Bank prior to the Act." *Id.* at 589-590.

The above enumerated property rights of the bank listed by the *Radford* Court were acquired under the state law of Kansas. The property rights of the Appellees were

acquired by mutual consent with the debtors under the state law of Colorado and they identically parallel those rights listed by the *Radford* Court. That is, the Uniform Commercial Code as adopted by Colorado afforded to the Appellees the very same rights, albeit in specific personal property, that Kansas law afforded to the bank in *Radford.*

The unabashed effect of Section 522(f)(2) of the Bankruptcy Code is the "total destruction" of all of these five property rights acquired by the Appellees in specific property for substantial value with the mutual consent of the debtors prior to the enactment of this Code section. Section 522(f)(2)'s total destruction of all of these five property rights actually represents a larger taking of rights in specific property, than the one prohibited in *Radford.* That is, if Section 522(f)(2) is allowed to operate retrospectively on these pre-enactment security interests, then the Appellees lose their liens completely. Wheras, even in *Radford,* the Bank was left with something under Section 75, Subsection (s) of the Bankruptcy Act:

> It would be more accurate to say that the only right under the mortgage left to the Bank is the right to retain its lien until the mortgagor, sometime within the five-year period, chooses to release it by paying the appraised value of the property. A mortgage lien so limited in character and incident is of course legally conceivable.

Without notice or hearing, Section 522(f)(2) totally destroys the rights to which the Appellees were entitled prior to its enactment, just as Section 75, Subsection (s) of the Bankruptcy Act totally destroyed the rights to which the bank in *Radford* was entitled prior to its passage. Thus, either *Radford* must be overruled, or this Court, should,

on the authority of *Radford*, hold that Section 522(f)(2) is unconstitutional as applied to security interests granted prior to the date of its enactment.

This Court has never yet retreated from *Radford* as the Government contends. In fact, Justice Powell in his concurring opinion in *Moore v. Regan*, 453 U.S. ..... (1981), cited *Radford* just last summer for the proposition which the Appellees are asserting here:

> "[I]t is settled than an attachment entitling the creditor to resort to specific property for the satisfaction of a claim is a property right compensable under the Fifth Amendment, *Armstrong v. The United States*, 364 U.S. 40 (1960), *Louisville Bank v. Radford*, 295 U.S. 555 (1935) . . ."

*Id.* at 101 S.Ct. 2972 at p. 2992.

*Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 440 (1937), (hereinafter cited as *Wright*), and its successors, did not retreat from *Radford* but only clarified its reasoning. In *Wright*, this Court upheld an amended version of Section 75, Subsection (s) of the Bankruptcy Act because that section "*adequately preserves* three of the five above enumerated rights of a mortgagee." *Id.* at 458 (emphasis added). In *Wright*, this Court, per Justice Brandeis, clarified *Radford*:

> The [*Radford*] opinion enumerates five important substantive rights in specific property which had been taken. It was not held that any one of these rights would have rendered the Act invalid, but *the effect of the statute in its entirety was to deprive the mortgagee of his property without due process of law.*

*Id.* at 457 (emphasis added). Even applying the reasoning of *Wright*, Section 522(f)(2) would be unconstitutional be-

cause the effect of this section *in its entirety* is to destroy totally all the value of the Appellees' liens or property rights as described above. Congress, by enacting Section 522(f)(2) and intending it to apply to pre-enactment security interests is totally destroying the value of the Appellees' liens without any notice, hearing or compensation whatsoever.

The Appellees contend that this Court has never and should never retreat from the central constitutional proposition of *Radford* that a retroactive statute which destroys a secured creditor's rights without notice is prohibited by the Fifth Amendment's Due Process Clause. This central constitutional proposition of *Radford* is at the very core of our nation's founding principles:

> There are acts which the federal . . . legislature cannot do, without exceeding their authority. There are certain vital principles in our free republican government, which will determine and overrule an apparent and flagrant abuse of legislative power . . . . A few instances will suffice to explain what I mean . . . a *law which takes property from A and gives it to B*: it is against all reason and justice for a people to intrust a legislature with such powers; and, therefore, it cannot be presumed that they have done it . . . .

*Calder v. Bull*, 3 U.S. (Dallas) 385, 388 (1798) (emphasis added).

Section 522(f)(2) does not adequately preserve any of the five *Radford* rights, and, in fact, totally destroys all five of these rights. Consequently, unless *Radford* is to be overruled, Section 522(f)(2) must be found by this Court to be unconstitutional.

## II. THE ALLEGED RATIONAL BASIS IN §522(f) CREATES AN IMPERMISSABLE PERMANENT IRREBUTTABLE PRESUMPTION

The Government also argues that Congress found certain facts in its pre-enactment hearings which afford a rational basis for Section 522(f)(2). The Government states that Congress found these security interests to be adhesion contracts with the creditors having little interest in the possession of the secured property because of its *de minimis* resale value. The Government states further that Congress found that creditors only threatened repossession in order to compel payment. These findings, according to the Government, afford a rational basis for the retrospective application of Section 522(f)(2), in that only by voiding these liens can debtors be truly given a "fresh start." However, "fresh starts" have always had limits, and they still do, as Section 523 lists nine types of nondischargeable debt. And, a debtor can, by utilizing 11 U.S.C. 722 redeem his secured property by paying to the lien holder the amount of the allowed secured claim. *See,* 11 U.S.C. 506(a) for the valuation of security interests. Thus, Section 722 has provided an alternative to the debtor's supposed dilemma of either surrendering the property or reaffirming the entire debt, by allowing him to pay a court determined value of the property interest. And, under Chapter 13, a debtor may also redeem such secured property with deferred payments based on a court determination of value. *See,* 11 U.S.C. §1325(a)(5)(B).

The Appellees, are not going to argue that Congress could have found a more rationale basis to give debtors fresh starts and creditors their property value. What the Appellees contend is that this congressional fact finding has created a constitutionally impermissible, permanent and irrebuttable presumption rather than a rational basis

for retrospective application for Section 522(f)(2). That is, with regard to the issues (1) Whether these security interests are adhesion contracts; (2) Whether these Appellees have little interest in the possession of the secured property; (3) Whether the property has a *de minimis* resale value; and (4) Whether these Appellees threatened repossession in order to compel payment, this Court only has legislative facts before it. The Appellees were permanently foreclosed from offering evidence in the lien avoidance hearing before the bankruptcy court which would establish facts different from those which Congress found in its pre-enactment hearings. In the cases at bar the Appellees were denied a fair opportunity by Congress from confronting these irrebuttable presumptions which are neither necessarily nor universally true. *Cleveland Board of Education v. La Fleur*, 414 U.S. 632 (1974). Such one-sided legislative fact finding is arbitrary and unreasonable. Such one-sided Congressional fact finding tries to make the Appellees out to be morally blameworthy for extending credit and taking property interests in household goods as security for their loans.

## CONCLUSION

Consequently, a retrospective application of Section 522(f)(2) is to be found unconstitutional for two good reasons. One, there is a complete taking of all of the lienholder's rights, a total destruction of all of the lienhold property interests analogous to *Radford*. Two, the purported rational basis for this retrospective application of Section 522(f)(2) is in reality nothing more than a permanent and irrebuttable presumption concerning facts which are neither necessarily nor universally true. Due process calls for a more individualized determination of the facts Congress

found. Thus, on either due process standard, a retrospective application of Section 522(f)(2) violates the Fifth Amendment.

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# Appellee's Brief

# 2

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No. 81-184

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1981

UNITED STATES OF AMERICA,

*Appellant,*

*v.*

SECURITY INDUSTRIAL BANK,
BENEFICIAL FINANCE OF KANSAS, INC., ET AL.

*Appellees.*

ON APPEAL FROM THE UNITED STATES
COURT OF APPEALS FOR THE TENTH CIRCUIT

## BRIEF OF APPELLEE BENEFICIAL FINANCE OF KANSAS, INC.

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## QUESTIONS PRESENTED

1. Whether § 522(f) of the Bankruptcy Act of 1978, which allows a debtor in bankruptcy to void liens vested in creditors prior to the Act, and does so without according to the creditor any compensation or any priority as against other creditors for the loss of his property interest, is constitutional, or whether it violates the Fifth Amendment?

2. Whether the applications to void Beneficial's liens were properly dismissed because the "bankruptcy judge" (referee) lacked the tenure and salary protections required by Article III of the Constitution for all federal judges exercising the "judicial power of the United States"?

3. Whether the Bankruptcy Act of 1978 is unconstitutional because it vests jurisdiction over all of its provisions in non-tenured "judges," and accordingly vests the "judicial power of the United States" in violation of Article III of the United States Constitution?

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BENEFICIAL FINANCE OF KANSAS, INC., ET AL.

*Appellees.*

ON APPEAL FROM THE UNITED STATES
COURT OF APPEALS FOR THE TENTH CIRCUIT

## BRIEF OF APPELLEE BENEFICIAL FINANCE OF KANSAS, INC.

## STATEMENT

This appeal arises out of seven different cases filed in the "Bankruptcy Courts" for the Districts of Kansas and Colorado. (J. S. App. 16a-59a). The seven cases were consolidated in a single appeal before the United States Court of Appeals for the Tenth Circuit. Each case questions the constitutionality of 11 U. S. C. § 522(f), a lien avoidance provision of the Bankruptcy Reform Act of 1978 (the "1978 Act" or the "Act"), Pub. L. No. 95-598, 92 Stat. 2549. Each case involves the statutory nullification in a bankruptcy proceeding of vested security interests without affording the owners of those interests either compensation or priority as against other creditors in the bankruptcy proceeding.

Appellee Beneficial Finance of Kansas, Inc. ("Beneficial") is a wholly-owned subsidiary of Beneficial Corporation. It is the secured creditor whose liens are sought to be extinguished

in the *Schulte* and *Hunter* cases. Beneficial Finance of Kansas, Inc., like numerous other subsidiaries of the Beneficial Corporation operating throughout the country, and like many other companies, is engaged in the consumer loan business. The various states in which Beneficial Corporation's consumer loan business operates regulate numerous aspects of that business, such as charges which can be assessed in making loans.

Although the specific loans which give rise to this appeal are relatively small, the number of personal bankruptcies filed in the United States since the effective date of the 1978 Act has increased dramatically and appellee is informed that many of those cases involve attempts to avoid liens pursuant to § 522(f). In the aggregate, the amounts of money involved in similar situations throughout the United States are thus very large.

In addition, the principle involved—retroactive nullification of vested security interests by means of bankruptcy legislation without affording persons deprived of those interests either compensation or priority as against other creditors—has broad implications extending far beyond the context of these cases. It is as relevant to major corporate and railroad bankruptcy proceedings as it is to individual bankruptcies, and the amounts potentially involved are huge.

The facts relating to the cases in which Beneficial is a secured creditor are as follows:

On December 10, 1977, almost a year before enactment of the 1978 Act, Randall Dean Schulte and Ollie Denise Schulte obtained a loan from Beneficial, and to induce this loan, granted Beneficial a security interest in their existing household and personal goods, certain of which were specifically listed and identified. On April 10, 1978, also prior to enactment of the 1978 Act, Richard Glen Hunter and Sharon Kay Hunter obtained a loan from Beneficial also secured by household goods, including certain listed and identified items. These security interests were suitably perfected according to Kansas law.

The 1978 Act came into effect on October 1, 1979,[1] almost two years after Beneficial's liens were created. Shortly thereafter, on October 22 and 30, 1979, respectively, the Schultes and Hunters filed petitions seeking bankruptcy relief under Chapter 7 of the Act. Both the Schultes and Hunters listed Beneficial as a secured creditor and listed the specified household goods in which Beneficial's liens were perfected as exempt property pursuant to the newly effective § 522(f) of Title 11 U. S. C. Each filed with the "United States Bankruptcy Court for the District of Kansas," a court purporting to act pursuant to powers granted by the 1978 Act, an "Application to Avoid Lien" seeking to avoid Beneficial's liens on the security pursuant to the newly enacted § 522(f).

Section 522(f) of the 1978 Act, a provision unique in the history of federal bankruptcy legislation, allows debtors under the Act to completely "avoid" liens on certain types of property, including liens on the specific household goods held by Beneficial. Where liens are avoided under § 522(f), they cease to exist. No provision exists for affording a creditor priority status as against other creditors, or for substitution of other property of like value, and no provision exists for payment of the lien value to the lienholder.

In this brief, appellee Beneficial submits not only that the ruling as to § 522(f) was correct, but that in any event, the order below must be sustained because a non-Article III Bankruptcy Judge may not constitutionally exercise jurisdiction under the 1978 Act, since the Constitution requires that the

[1] The 1978 Act was enacted on November 6, 1978, with most parts (including § 522(f)) to become effective on October 1, 1979, and the other parts (including the "United States Bankruptcy Courts") to become effective on April 1, 1984, although during the so-called "transition," the referees in bankruptcy, sometimes referred to as bankruptcy "judges", are to exclusively exercise all the original jurisdiction and powers afforded the new bankruptcy courts. Pub.L. 95-598, Title IV, §§ 402, 404, 405, 92 Stat. 2682, 2683-85 (1978).

jurisdiction conferred by that Act must be vested in Article III judges. Since the Bankruptcy Act of 1978 vests exclusive jurisdiction to administer its provisions in courts and judges who may not constitutionally do so, the court below should have dismissed the proceedings on this fundamental threshold ground, despite the fact that the Article III issue was not raised before it.[2] While Beneficial does not contest that certain functions of an essentially administrative nature could constitutionally be assigned to non-Article III officials in a bankruptcy proceeding, Beneficial does submit that the power to adjudicate claims of the type at issue herein may not constitutionally be vested in anyone other than an Article III judge.

## SUMMARY OF ARGUMENT

The 1978 Bankruptcy Act cannot constitutionally be applied here to invalidate Beneficial's liens for two fundamental reasons:

### I.

Section 522(f) of the 1978 Act affords debtors under that Act the right to void liens on certain types of personal property, including household goods (which are at issue here), without providing any offsetting or compensating priority, substitution, or adequate compensation. As applied to valid liens which preexisted enactment of the statute, affording debtors such a right at the expense of their secured creditors effects a taking of private property without compensation or due process of law, contrary to the Fifth Amendment.

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[2] In order to avoid any possible procedural issues before this Court, Beneficial has also filed a cross-appeal (No. 81-583), which raises the identical Article III question. This Court has not noted probable jurisdiction in that cross-appeal.

It has been settled, and the government concedes, that the bankruptcy power is subject to the Fifth Amendment. *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555 (1935). The private property rights protected by the Fifth Amendment include all liens arising from security interests valid under applicable state law, regardless of whether these are on real or personal property or are considered "purchase money" or "possessory." Congress may not retroactively destroy private property rights under the bankruptcy laws, or otherwise, without making adequate provision for substitution, priority, or other adequate compensation. At a minimum, § 522(f) destroys the position of secured creditors versus unsecured creditors without any offsetting benefit. Although the government characterizes the secured interests here as "small" in value, we know of no way the principle invoked to justify § 522(f) can be so limited. Moreover, the supposed "public purpose" invoked— subsidizing the debtor's "fresh start"—cannot lawfully be achieved at the expense of secured creditors with previously existing property interests. *Pennsylvania Coal Co.* v. *Mahon*, 260 U. S. 393, 416 (1922) (Justice Holmes).[3]

## II.

The jurisdiction of the untenured bankruptcy courts below to conduct these proceedings is a fundamental threshold question facing this Court. The absence of constitutional jurisdiction in the bankruptcy courts over these proceedings provides a clear-cut alternative ground for affirmance, even though the

[3] The purported justifications offered for why Congress can destroy these liens—they are sometimes obtained under "unconscionable" circumstances, they are often of "small" value, they are used principally to effectuate repayment of the underlying debt, and so forth—are the kind of justifications which can always be offered to destroy any type of property interest, especially for those who believe, with the 19th Century French philosopher Proudhon, that "Property is Theft." No judicial findings supporting any charge of "undue influence" exist in these cases.

issue is raised for the first time on this appeal. *Glidden Co.* v. *Zdanok*, 370 U. S. 530, 536-37 (1962).

That the 1978 Act vests the "judicial Power of the United States" in untenured "judges" is indisputable. With insignificant exceptions, the bankruptcy judges (referees) possess all the judicial powers of the district courts, and more. Congressional power to create a nationwide system of inferior courts to adjudicate matters "arising under" federal bankruptcy law derives exclusively from Article III and must conform to the requirements for judicial independence found in that Article.

No decision of this Court has ever supported the excision of jurisdiction from an Article III Court and its vesting in an untenured tribunal, nor has any decision suggested this could be done in matters of "private" right. *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U. S. (18 How.) 272 (1856). In fact, an unbroken line of decisions has repeatedly affirmed that a federal litigant in a controversy involving the distinctively judicial power is entitled to a constitutional court endowed with the protections of Article III. *Ex parte Milligan*, 171 U. S. (4 Wall.) 2 (1867); *Glidden Co.* v. *Zdanok*, *supra*.

The only situations in which Congress may vest the judicial power of the United States without reference to Article III relate to the adjudication of controversies where the source of judicial power is found in the Territorial clause or the District of Columbia clause or special subject matters related to controversies with the United States or within the military. In the territories, Congress is endowed with the powers of a state and federal government, and constitutional separation of powers does not apply. Customs matters and claims against the United States are situations where resolution of disputes has been, constitutionally and historically, exclusively committed to the Legislative or Executive branches. Matters of a distinctively judicial nature, however, involving resolution of private rights,

have never been susceptible to such executive or legislative decision, and may not be vested in non-Article III tribunals. *Murray's Lessee, supra.*

Nor can these bankruptcy courts be sustained as administrative agencies. The vast range of judicial powers, including full enforcement powers, vested in these courts mark them as distinctively judicial—such powers could not constitutionally be given to an administrative agency. *ICC* v. *Brimson*, 154 U.S. 447 (1894). In addition, the total delegation of Article III authority here, free from supervision, direction, or control of the district courts, clearly violates the standards established by this Court in *United States* v. *Raddatz*, 447 U.S. 667 (1980). Article III requires that all courts in which the judicial power of the United States has been vested conform to its provisions, and the provision of an appeal to an Article III court does not obviate the necessity of compliance.

Since the 1978 Act provides exclusively for its administration and for the adjudication of matters thereunder by the so-called bankruptcy judges (referees), and since they cannot constitutionally exercise that power, the 1978 Act as a whole is unconstitutional.

## ARGUMENT

### I.

### SECTION 522(f) MAY NOT CONSTITUTIONALLY BE APPLIED RETROACTIVELY TO TAKE AND DESTROY BENEFICIAL'S PRE-EXISTING PROPERTY INTERESTS.[4]

#### A.

#### The Fifth Amendment Protects Beneficial's Liens.

The Constitution of the United States provides that:

> No person shall . . . be deprived of life, liberty, or property, without due process of law; *nor shall private property be taken for public use without just compensation.*

U. S. Const., Amendment V (emphasis added.)

In this case, Beneficial was granted property rights in certain existing, identified items as security for loans. There is no question, and the government does not contest the fact, that at the time they were created, these property rights were valid liens under state law and Beneficial was entitled to the protection thereof under the federal Constitution. Subsequently, Congress passed the "Bankruptcy Reform Act of 1978", in-

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[4] Other than this case, there are two decisions on § 522(f) in the courts of appeal. *In re Gifford*, No. 81-1174 (7th Cir., January 21, 1982) (§ 522(f) construed to be prospective only); and *In re Ashe*, No. 81-1629 (3d Cir., January 6, 1982) (§ 522(f) upheld against constitutional challenge). These cases, like this case, deal only with secured interests which had been created and were in effect prior to the time the 1978 Act was enacted. This Court need not here deal with the issue of whether § 522(f) can be validly applied to property interests created after enactment, as to which, despite the apparent ambiguity of the statute, it could be argued that creditors were on "notice".

cluding § 522(f) thereof,[5] which purports to invalidate Beneficial's liens.

Retroactively applied to Beneficial's pre-existing liens, § 522(f) of the 1978 Act would unarguably accomplish the following results: (1) Beneficial, which had property rights in these goods, would have no rights in them at all; (2) Beneficial, which could have realized upon the value of these goods to fulfill the loan obligations, realizes nothing; (3) the government, which decrees this result, makes no provision for offsetting this obvious injustice. No substitution of collateral, priority with respect to other creditors, or any other form of adequate compensation is provided.[6]

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[5] 11 U. S. C. § 522(f) states in pertinent part:

> (f) Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—
>
> (1) a nonpossessory, nonpurchase—money security interest in any—
>
> (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
>
> * * *

Section 522(b) provides that a debtor may exempt from property of the estate property specified in § 522(d), which includes the items of household goods at issue here.

[6] It should be remembered that the bankruptcy laws also provide a mechanism for adjusting the rights of creditors *inter sese*—as well as with the debtor. Those rights must be so adjusted as to validate liens and other property rights—at least by giving priority in the distribution of assets to creditors who hold liens on the property involved. *Gardner* v. *New Jersey*, 329 U. S. 565, 576 (1947); *Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523, 570 (1943); *Northern Pacific Ry. Co.* v. *Boyd*, 228 U. S. 482, 503 (1913).

## B.

### The Government's Arguments Would Destroy the Fifth Amendment's Protection of Private Property.

The government argues that the liens here may be destroyed because (1) a valid public purpose is involved—affording a "fresh start" to debtors (Br. U. S. at 17-26), (2) the Fifth Amendment's protection of "private property" does not extend to private property Congress deems not worth of protection (Br. U. S. at 37-41), (3) § 522(f) is a permissible government "regulation," and as such does not effect a "taking" (Br. U. S. at 34), and (4) in any event "the rights of a secured creditor may be substantially impaired in the exercise of Congress' bankruptcy power." (Br. U. S. at 32). These arguments constitute, singularly and in total, no less than a frontal assault on the Fifth Amendment's protection of private property and on this Court's decisions applying that provision. The principle for which the government contends is indeed far reaching: for example, in the case of a bankruptcy or reorganization of a railroad or other corporation the principle would permit destruction of the security interest of public lienholders of mortgage bonds without compensation or provision for priority. If accepted, the private property rights of the citizenry—a principal foundation of our constitutional system—would stand bare before the shifting winds of Congressional and political "discretion."[7]

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[7] The government devotes a substantial portion of its Brief to the argument that § 522(f) does not infringe "substantive due process" because it is a "rational" exercise of governmental power. (Br. U. S. at 14-26.) This argument is highly questionable in light of the vast overbreadth of the statute, which retroactively voids private property interests regardless of the existence of any judicial finding of "unconscionability," "undue influence," or similar alleged "justification". That Congress enacted no general prohibition, but purported to invalidate liens on household goods only if the debtor files for bankruptcy, shows that the "unconscionability" justification cannot

*(Footnote continued on following page.)*

C.

**This Court Has Consistently Enforced the Fifth Amendment's Prohibition Against Taking Property Such as These Liens.**

The government contends that eliminating Beneficial's liens and giving them to the debtor is a "public use" within the intendment of the Fifth Amendment: indeed its argument is premised on the purported strength of the public purpose (a "fresh start") here. But as pointed out by Justice Cardozo in *W.B. Worthen Co.* v. *Kavanaugh*, 295 U. S. 56, 60-62 (1935), "[e]ven when the public welfare is invoked as an excuse," "the incidents that give attractiveness and value to collateral security" may not be destroyed.

The government concedes, and it has been long settled, that the bankruptcy power of Congress is subject to the Fifth Amendment. (Br. U. S. at 32.) *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 589-90 (1935). And we concede that the objective of providing debtors with a "fresh

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carry far. And it does not seem to be "rational" legislation to retroactively compel Beneficial to subsidize these debtors' "fresh start," especially in light of the strength of the constitutional interest in protecting private property involved and the absence of any showing that security interests of this character caused or significantly contributed to these debtors filing for bankruptcy. *Cf. Usery* v. *Turner Elkhorn Mining Co.*, 428 U. S. 1, 18-19 (1976); *Allied Structural Steel Co.* v. *Spannaus*, 438 U. S. 234, 247-50 (1978) (retroactive, severe, permanent alterations in private pension fund provisions unconstitutionally impairs contract); *United States Trust Co.* v. *New Jersey*, 431 U. S. 1, 22 (1977). But at any rate there does not appear to be need to address this contention since the patent defect in § 522(f) is that it effectuates an unconstitutional taking, in violation of that section of the Fifth Amendment prohibiting such actions without "just compensation." The government concedes that "If the Court ... concludes that § 522(f)(2) constitutes a taking," no provision for "just compensation" exists. (Br. U. S. at 48, n. 27.)

start" may be laudable. But it is not a permissible "public" purpose to take private property where the animating or principal purpose or effect is to transfer ownership from A to B, even though just compensation be paid. *See, e.g., Wilkinson* v. *Leland*, 27 U. S. (2 Pet.) 627, 657-58 (1829); *Madisonville Traction Co.* v. *St. Bernard Mining Co.*, 196 U. S. 239, 251-52 (1905). Such legislation is not "for an end which is in fact public". *Treigle* v. *Acme Homestead Assoc.*, 297 U. S. 189, 197 (1936).

But even disregarding the essentially private effect here, the arguments urged in support of § 522(f) are not new. We do not write upon a blank slate. In fact, the government's principal arguments here have already been raised and rejected by this Court. The government's brief seeks not only to turn back the clock, but also to reverse this Court's decisions going back almost fifty years.

Thus in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555 (1935), this Court invalidated, as an unconstitutional taking without compensation, an act of Congress (the Frazier-Lemke Act) which prevented a holder of a mortgage lien on farm property created prior to that Act from realizing on his security interest during a five-year period, during which the mortgagor remained in exclusive possession and control of the property, and the mortgage lienholder received only a reasonable rental on the property. No assurance existed that the value of the security would be protected.

The Frazier-Lemke Act, like § 522(f), was passed to afford increased debtor relief and enhance a debtor's "fresh start." *Id.* at 582, 598-601. Like the government here, the mortgagor argued these were reasonable and important "public purposes" designed to meet a national "emergency." *Id.* at 598-601. Justice Brandeis, for the unanimous Court, pointed out that under the Fifth Amendment's taking clause, "[w]e have

no occasion to consider [these matters]... These are matters for the consideration of Congress." *Rather*, he said,

> the province of the Court is limited to deciding whether the Frazier-Lemke Act as applied has taken from the Bank without compensation, and given to Radford, rights in specific property which are of substantial value.... As we conclude that the Act as applied has done so, we must hold it void. For the Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest required, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public.

295 U. S. at 601-02. *See also W. B. Worthen Co.* v. *Kavanaugh*, 295 U. S. 56, 60 (1935).[8]

In *Radford*, this Court upheld a lien as against an unconstitutional taking even though the value of that lien was not totally destroyed, but had been reduced by about one half, *id.* at 577, and even though the lienholder's rights were not

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[8] And in voiding a state law, assumed to address a current "exigency", which retroactively prohibited a coal company from mining subsurface coal on property on which a house had been built, but in which the company had explicitly retained mining rights, Justice Holmes for the Court emphasized:

> The protection of private property in the Fifth Amendment presupposes that it is wanted for public use, but provides that it shall not be taken for such use without compensation.... When this seemingly absolute protection is found to be qualified by the police power, *the natural tendency of human nature is to extend the qualification more and more until at last private property disappears.* But that cannot be accomplished in this way under the Constitution of the United States.

*Pennsylvania Coal Co.* v. *Mahon*, 260 U. S. 393, 415 (1922) (emphasis added).

obliterated, only delayed. Here , by contrast, Beneficial's liens would be rendered totally valueless by § 522(f) and none of its rights whatsoever to the property would remain. This case follows *ipso facto* from *Radford.*[9]

Following *Radford,* the government's destruction of a materialmen's lien on personal property was held to be an unconstitutional taking in *Armstrong* v. *United States,* 364 U. S. 40 (1960). The liens involved arose because of work done on a ship subsequently commandeered by the government, which sought to avoid paying for them. This Court, by Justice Black, held that:

> *The total destruction by the Government of all value of these liens, which constitute compensable property, has every*

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[9] *Radford's* formulation that the Fifth Amendment protects "rights in specific property which are of substantial value" is clearly satisfied here. Beneficial's rights under Kansas law by virtue of its liens include the rights (1) to take possession and dispose of the collateral upon default; (2) to have the collateral sold, publicly or privately; (3) to buy the collateral at public or private sale; (4) to retain the collateral in satisfaction of the debt; (5) to replevy the collateral; (6) to reduce its claim to judgment; and/or (7) to sue for any deficiency after disposition of the collateral. *See* Kan. Stat. Ann. §§ 60-1005 *et seq.,* 61-2401 *et seq.,* 84-9-501, *et seq.* Section 522(f) would destroy those rights entirely. In *Radford* the taking of those similar rights was found to occur not through destruction, as here, but through undue delay.

In contrast to Beneficial's rights in specific property, an unsecured creditor only has a right to sue for damages and to share *pro rata* in whatever assets remain after distribution to secured creditors. Note, *Constitutional Limitations on the Bankruptcy Power: Chapter XII Real Property Arrangements,* 52 N. Y. U. L. R. 362, 365 n.16, 390-93 (1977).

The government's further argument that *Radford* does not apply because the liens here are not in "specific property" but rather are "blanket" liens that "do not attach to any particular items" (Br. U.S. at 40) neglects the fact that under Kansas law Beneficial's liens on all existing household goods are valid, and are liens on specific property. Kan. Stat. Ann. §§ 84-9-110, 84-9-201(1)-(3). Furthermore, Beneficial's liens here are on *specifically* listed and identified items.

> *possible element of a Fifth Amendment "taking"* and is not a mere "consequential incident" of a valid regulatory measure. Before the liens were destroyed, the lienholders admittedly had compensable property. Immediately afterwards, they had none. This was not because their property vanished into thin air. It was because the Government for its own advantage destroyed the value of the liens, something that the Government could do because its property was not subject to suit, but which no private purchaser could have done.

364 U. S. at 48-9 (emphasis added).

*Armstrong* and *Radford* apply with full force here. If the Fifth Amendment protected the materialmen's liens in *Armstrong* and the mortgage lien in *Radford*, it surely protects Beneficial's liens in "specific property" here.[10]

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[10] The government's argument that *Radford* has been "eroded" by subsequent decisions (Br. U. S. at 28-29), and "must be treated as limited to its facts" (Br. U. S. at 32), overdramatizes and misconstrues the later cases. Thus, for example, in *Wright* v. *Union Central Life Ins. Co.*, 311 U. S. 273 (1940), which the government relies on to show a "retreat" from *Radford*, Justice Douglas for the Court said, describing the Act there in question:

> Safeguards were provided to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property.... There is no constitutional claim of the creditor to more than that .... [T]he creditor will not be deprived of the assurance that the value of the property will be devoted to the payment of his claim.

311 U. S. at 278-79.

Justice Douglas reaffirmed the secured creditor's right to be "paid the full amount of what he can constitutionally claim." *Id.* In *Union Central*, as in *Radford*, the Constitution was held to protect secured creditors' liens to their full value. Here by contrast, it is proposed that Beneficial's liens be *totally* destroyed and that Beneficial be paid *nothing*. Thus whatever the intricacies, if any, of the cases from *Radford* to *Union Central*, these intricacies are utterly irrelevant here. Contrary to the assertions of the government, all these cases affirm the proposition that the rights of a secured creditor must be

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## D.

## Although the Constitution Allows Congress to Impair Contracts Through Reasonable and Uniform Bankruptcy Laws, It Prohibits Congress From Taking Property Without Provision for Priority or Other Compensation.

### 1.

### The Constitution, Not Appellees or This Court, Draws the Line Between Property and Contract.

In a frontal assault on the Constitution and this Court's prior decisions, the government argues that liens can be destroyed because the distinction drawn between contract rights, which Congress can impair, and property rights which it cannot, is "simplistic" and "is not reflected in the decisions of this Court." (Br. U. S. at 29-30.) But it is not this Court nor appellees who draw this distinction; it is founded in the Constitution itself. As this Court has explained:

> The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the States, it is not prohibited from impairing the obligation of contracts. [cite] But the effect of the Act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the Bank prior to the Act.

*Radford, supra,* 295 U. S. at 589-90.

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provided for. *See also Wright* v. *Vinton Branch,* 300 U. S. 440 (1937) (Amended Frazier-Lemke Act designed to conform to *Radford* and protect secured creditor's rights construed to do so); *John Hancock Mutual Life Ins. Co.* v. *Bartels,* 308 U. S. 180, 186 (1939) (court can sell secured property to protect the secured party); Comment, *The Secured Creditor's Right to Full Liquidation Value in Corporate Reorganizations,* 42 U. Chi. L. Rev. 510, 518-19 (1975).

The constitutional provision that "No state shall . . . pass any . . . law impairing the Obligation of Contracts . . ." (Article I, Section 10), has no strict parallel for Congress, *Hanover National Bank* v. *Moyses*, 186 U. S. 181, 188 (1902), although Congress' powers in that regard are limited by the due process requirement of reasonableness. *See, e.g., Exxon Corp.* v. *Governor of Maryland*, 437 U. S. 117, 125 (1978). Since the Constitution provides that "Congress shall have Power . . . to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States," Article I, Section 8, clause 4, and since a bankruptcy law by its nature impairs the obligation of contract, it is obvious that Congress has such a power.

But although Congress is not subject to the provision prohibiting the impairment of the obligation of *contract*, it is specifically prohibited by the Fifth Amendment from taking private *property* without just compensation. Thus the distinction between Congress' powers with respect to contracts on the one hand and property on the other may be "simplistic," as the government contends, but it is nonetheless founded upon the Constitution and essential to our freedoms under it.

Thus, contrary to the government's argument, the rights of a secured creditor in specific property are constitutionally protected from taking or destruction by Congress while those of an unsecured creditor in bankruptcy are not so broadly protected, and this distinction flows from the Constitution itself. The government's argument that "bankruptcy principles do not support a sharp distinction between the rights of secured and unsecured creditors" (Br. U. S. at 31) flies in the face of the language and structure of the Constitution, as well as numerous prior cases.[11] For there can be no mistaking the constitutional reference when Mr. Justice Brandeis long ago pointed out that:

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[11] The government's reliance on procedural due process cases (Br. U. S. at 30) for the proposition that no distinction exists between contract and property rights is refuted by itself; the constitutional considerations are very different, as the government admits (Br. U. S. at 30) ("the meaning of property for procedural due process purposes is perhaps broader than in the context where a taking is alleged . . .").

> It is true that the position of a secured creditor, who has rights in specific property, differs fundamentally from that of an unsecured creditors, who has none; . . .

*Radford, supra,* 295 U. S. at 588.

And there was no mistaking this Court's meaning when it said in *Kuehner* v. *Irving Trust Co.*, 299 U. S. 445, 451-52 (1937), that "there is, as respects the exertion of the bankruptcy power, a significant difference between a property interest and a contract." *See also Ginsberg* v. *Lindel*, 107 F. 2d 721, 726 (8th Cir. 1939); Note, *Constitutionality of Retroactive Lien Avoidance under Bankruptcy Code Section 522(f)*, 94 Harv. L. Rev. 1616, 1634, n. 118 (1981) (hereinafter "*Retroactive Lien Avoidance*").

The government's suggestion that this distinction, and the definition of "private property", lie "wholly within the discretion of Congress" (Br. U. S. at 31) neglects entirely the constitutional provisions involved. Also, this suggestion, if accepted, would allow Congress to amend constitutional provisions designed to limit its powers, and to do this by majority vote, contrary to Article V, which provides for such amendment only upon ratification by the legislatures or conventions of three fourths of the States.

2.

**A Valid Lien Under State Law Is Protected From Destruction by Congress Regardless of Whether It Is a "Possessory" or "Purchase Money" Lien.**

The Constitution, Amendment V, draws no distinction between kinds of valid, state-created property interests. *Armstrong* v. *United States, supra*, at 40, 44. It expressly prohibits Congress from destroying any kind of "private property" without affording priority or other compensation. All property interests—whether or not "purchase money" or "posses-

sory"—valid under state law are protected.[12] The distinction drawn by the government finds no support in the Constitution.

Nor do the cases support any such distinction; in fact they refute it. Thus the lien in *Radford* was a mortgage on a farm, but did not arise from a loan given to purchase the farm. *Id.* at 573, n. 4. Like Beneficial's lien here, it was a "non-purchase money, non-possessory" lien of the sort the government would deny constitutional protection. The only difference was that the lien secured real property.

The government fastens on this difference, but its reliance on a distinction between "real" and "personal" property not only finds no support in the Constitution, but also is refuted by *Armstrong* v. *United States, supra,* in which this Court found an unconstitutional taking of a materialmen's lien in "personal" property, to wit, a ship.[13]

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[12] It is state law which defines the property rights protected. Thus in *Radford, supra* at 590, "in order to determine whether rights of that nature have been taken", this Court turned to the "law of Kentucky," from where the interest arose. The government concedes and there is no question that Beneficial's liens are valid under Kansas law, which expressly recognizes the validity of a lien on a debtor's personal property and household goods. Kan. Stat. Ann. § 84-9-110 (Kansas comment); *Emick* v. *Swafford,* 107 Kan. 209, 191 P. 490 (1920).

[13] As this Court observed:

> No reason has been suggested why the nature of the liens held by petitioners should be regarded as any different, for this purpose, from the interest of the bank held compensable in *Radford.*

*Armstrong* v. *United States, supra,* 364 U. S. at 44. *See also Ginsberg* v. *Lindel,* 107 F. 2d 721 (8th Cir. 1939) (landlord's lien on all of his lessee's personal goods on the premises is valid and protectable against a taking).

The government argues *Armstrong* has "no relevance" here (Br. U. S. at 38) because there the *government* ended up with the property

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Thus not only is the government's argument refuted by the language of the Constitution, but it has previously been rejected in a course of decisions by this Court going back nearly 50 years. Moreover, the further distinction urged between liens on secured property which has been "directly benefited, or acquired as a result of, the loan" (Br. U. S. at 39), and other liens makes no legal or economic sense. What constitutional difference can it make if A loans money to B *in order to* acquire a car (purchase money loan), or if A loans money to B to pay off debts, thereby *enabling* him to acquire a car (non-purchase money loan), if the car is the agreed-upon security in both instances.[14]

3.

**The Government's Additional Objections to These Liens Do Not Alter Their Validity.**

Moreover, the government's attempt to denigrate and carve up the kinds of property interests within the Fifth Amendment is dangerous to our freedoms. The principle urged by the government cannot be confined to the interests here. As

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rather than a private citizen. This argument neglects the fact that it is "the deprivation of the former owner rather than the accretion of a right or interest to the sovereign" that constitutes a taking. *United States* v. *General Motors Corp.*, 323 U. S. 373, 378 (1945). *See also Aris Gloves, Inc.* v. *United States*, 420 F. 2d 1386, 1391 (Ct. Cl. 1970).

The principle of *Armstrong* and *Radford* that all kinds of liens are protected private property follows the law generally applied. *See generally* 16 C. J. S. *Constitutional Law*, § 233 ("as a general rule a lien once acquired is held to be a vested property right which may not be impaired by subsequent legislation"); *Manchester* v. *Popkin*, 237 Mass. 434, 130 N. E. 62 (1921) (mechanic's lien); *United States* v. *One 1962 Ford Thunderbird*, 232 F. Supp. 1019 (N. D. Ill. 1964) (security interest in car).

[14] Such distinctions only have relevance, if at all, in establishing lien priorities under state law. *See, e.g.*, Kan. Stat. Ann. § 84-9-312.

Justice Holmes warned, "When this seemingly absolute protection [against taking private property] is found to be qualified by the police power, the natural tendency of human nature is to extend the qualification more and more until at last private property disappears." *Pennsylvania Coal Co.* v. *Mahon*, 260 U. S. 393, 415 (1922).

As shown, the relevant questions for taking purposes are (1) whether the interest involved is a recognized, valid property interest under applicable state law and, if so, (2) whether rights in that property have been destroyed or otherwise taken. Both conditions are met here.

The government urges, however, that Congress should be able to destroy Beneficial's valid property rights because certain members of Congress expressed the opinion that "often" similar liens are obtained by "overreaching creditors" and are "unconscionable." (Br. U. S. at 43.) The short answer is that no findings in this record would support any such conclusion here. *See Willie* v. *Southwestern Bell Tel. Co.*, 219 Kan. 755, 549 P. 2d 903 (1976) (outlining 10 factors to determine "unconscionability"); Kan. Stat. Ann. § 16a-5-108 (Kansas comment) ("the particular facts involved in each case are of utmost importance since certain contracts or contractual provisions may be unconscionable in some situations but not in others".)[15]

The government next argues that these liens should not be protected because "the value of the secured property to the secured creditor is *de minimus*" and "the creditor has no interest

[15] Although the government states that "Congress found" this unconscionability to exist (Br. U. S. at 43, 21, 22, 25, 40), Congress actually made no such finding. Moreover it is hard to see how any such legislative "finding" could constitutionally apply in any event to invalidate the liens in these cases without dangerously jeopardizing the separation of powers. *See, e.g., Buckley* v. *Valeo*, 424 U. S. 1, 132-33 (1976); *cf., Marbury* v. *Madison*, 5 U. S. (1 Cranch) 137 (1803). Accepting the government's approach would provide a basis for the wholesale destruction of constitutional rights by congressional fiat.

whatsoever in possession of the household goods," being only interested in their "threat" value to compel repayment. (Br. U. S. at 41-42).[16] As with the other arguments based on so-called "congressional findings," nothing in the record supports any such finding, and it would be destructive to our constitutional institutions to permit retroactive disfeasance of someone's property by any such congressional dictate. Moreover, taken collectively, the property interests at stake here are enormous. In Kansas alone, for the year 1979, loans secured by household goods totaled over $100 million. *1979 Ann. Rept. of the Consumer Credit Commissioner, State of Kansas*, at 11.[17]

That the government's arguments here are really a frontal assault on the Constitution is further revealed by its assertion that it is "clear that the rights of a secured creditor may be substantially impaired in the exercise of Congress' bankruptcy power," citing the *New Haven Inclusion Cases*, 399 U. S. 392 (1970). (Br. U. S. at 32.) The government's proposition stands the true law on its head. If anything is clear from *Radford*,

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[16] The "threat" argument could apply to any secured transaction; lienholders, regardless of the type of security, are primarily interested in repayment of the debt. *See* Note, *Retroactive Lien Avoidance*, 94 Harv. L. Rev. 1616, 1632 (1981).

[17] The fact that the monetary value of Beneficial's liens seems "small" to the government (Br. U. S. at 44), does not belie the fact that their realizable value is a large percentage of the "small" underlying loans. Moreover, it is "not the business of the court, in adjudicating Fifth Amendment rights, to protect only property that is 'valuable'." *North Georgia Finishing, Inc.* v. *Di-Chem Inc.*, 419 U. S. 601, 608 (1975). Ironically, the government seeks a distinction here with *Radford* on the basis that the value of mortgages there was indicated by the retroactive-only aspects of the legislation, suggesting fear that farmers' sources of credit would dry up if the legislation applied to future loans. (Br. U. S. at 40 n. 21.) The irony is that § 522(f) has had precisely that effect. Many lenders, including Beneficial, now make few loans based on household goods security at all, and thus the new bankruptcy legislation has had the harmful effect of drying up sources of credit for these people.

*Wright* v. *Union Central Life Ins. Co.*, and *Armstrong*, it is that the value of a secured creditor's lien rights may *not* be substantially impaired consistent with the Fifth Amendment. *New Haven Inclusion Cases* does not hold otherwise. That case fully recognized the value of the creditors' liens. As the Court said, "We thereby accord the lienholders the right to a liquidation and a per-parcel sale that is theirs by virtue of their mortgage liens." *New Haven Inclusion Cases*, 399 U. S. at 489-90.[18]

The government's further argument that § 522(f) may validly be applied to pre-existing liens because it is "a classic example of government regulation for the common good", (Br. U. S. at 34), proves too much. If § 522(f) can be justified on that basis, so can any taking. Far from being a classic example of regulation with only "consequential incidents" on someone's property, (*Armstrong* v. *United States*, 364 U. S. at 48), § 522(f) is a classic example of a direct taking—it commands A to relinquish his property interest and *give it to B*, to the benefit of both the debtor and other creditors. This is a far cry from the type of general health or safety regulation with only "consequential" effects on property sometimes upheld in other circumstances. *See, e.g., Miller* v. *Schoene*, 276 U. S. 272

[18] The government also refers to the effect of voidable "preference" provisions as demonstrating that a secured creditor's property may be impaired. But it is only *lawful* and valid liens that are protected, not ones unlawfully obtained. Additionally, provisions prohibiting unlawful preference provisions are not applied retroactively to invalidate preexisting rights. *Auffm'ordt* v. *Rasin*, 102 U. S. 620, 621 (1881). And *Local Loan Co.* v. *Hunt*, 292 U. S. 234, 243 (1934), also relied upon, did not involve any impairment of a lien on existing property at all, because the debtor's assignment of future wages created no present existing lien, only "prospective liens". *Id.* at 243. *American Surety Co.* v. *Sampsell*, 327 U. S. 269 (1946), also relied upon, similarly involved no lien impairment.

(1928); *Penn Central Trans. Co.* v. *New York City*, 438 U. S. 104 (1978).[19]

As recently pointed out in Note, *Retroactive Lien Avoidance*, 94 Harv. L. Rev. 1616, 1623-24 (1981), this Court "has never retreated" from the principles (1) that the value of a security interest is a protected Fifth Amendment property right and (2) that the secured creditor cannot constitutionally be deprived of the collateral's liquidation value without some form of adequate compensation. *See also Regional Rail Reorganization Cases*, 419 U. S. 102, 154-56 (1974); *New Haven Inclusion Cases*, *supra* at 489-94. Further, deprivation of private property is not rendered any less unconstitutional by the reasonableness of the government's objective; all legislation which effects a taking comes laden with presumptions that it serves a "public purpose." If it does not, the legislation may not be validly enacted at all.

**4.**

**In Any Event, Congress Did Not Intend § 522(f) to Apply Retroactively.**

Changes in the preliminary drafts of the savings clause of the 1978 Act strongly suggest that Congress did not intend

[19] It is the *right* or interest involved which is most constitutionally significant for "taking" purposes. Thus, whereas a secured creditor's *right* to the value of his collateral security is entitled to Fifth Amendment protection (*see, e.g., Radford, supra, Wright* v. *Union Central Life Ins. Co.*, 311 U. S. 273 (1940)), one's *interest* in the zoning of one's property, for example, is not normally sufficiently substantial to merit Fifth Amendment protection. *Euclid* v. *Ambler Realty Co.*, 272 U. S. 365 (1926). This is the basis upon which valid "regulations" do not ordinarily constitute a taking. Instead, a "weighing of private and public interests" is necessary to determine whether the effect of the law is so severe that the Fifth Amendment is brought into play. *See, e.g. Agins* v. *Tiburon*, 447 U. S. 255, 260-61 (1980) (the zoning laws involved "neither prevent the best use of appellant's land . . . , nor extinguish a fundamental attribute of ownership".)

§ 522(f) to apply retroactively. Preliminary drafts expressly required retroactive application. For example, H. R. 31, 94th Cong., 1st Sess., §§ 10-103(a) (1975), *reprinted in Bankruptcy Act Revision: Hearings on H. R. 31 and H. R. 32 before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary,* 94th Cong., 1st Sess. (1975), n. 14 app. at 320-21, (hereinafter *"House Hearings"*), stated that the new bankruptcy law "shall apply in all cases or proceedings instituted after its effective date, *regardless of the date of occurrence of any of the operative facts determining legal rights, duties or liabilities hereunder.*" (Emphasis added.) However, in 1976, a consultant to the Commission on the Bankruptcy Law of the United States suggested exceptions to retroactivity in order to avoid constitutional problems. *House Hearings, supra,* at 2034, 2066-67 (statement of William Plumb, Jr.). In particular, the consultant noted that proposed section 4-606 (H. R. 31, 94th Cong., 1st Sess., § 4-606 (1975) *reprinted in House Hearings,* n. 14 app. at 175-76), which invalidated certain liens on property of the debtor's estate, could be viewed as an improper impairment of vested property rights if applied retrospectively. *House Hearings, supra,* at 2066. Since retroactive lien destruction under H. R. 31 § 4-606, was "cast [in] doubt," *id.,* the original language in the savings clause requiring retroactivity was dropped. *See* Pub. L. 95-598, Title IV, § 403(a). Thus the strong suggestion is that Congress did not intend retroactivity. *Cf. Bradley* v. *Richmond School Board,* 416 U. S. 696, 716 n. 23 (1974).[20]

The judgment below should be affirmed because § 522(f) may not constitutionally be applied, and may not have been intended to be applied, to void Beneficial's preexisting liens.

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[20] This evidence is supported by the usual rule that a statute is presumed to apply prospectively only unless a contrary intention is the "unequivocal and inflexible import" of its terms and the manifest intent of the legislature, *Greene* v. *United States,* 376 U. S. 149, 160 (1964), and by the references to *Radford* in the legislative history to

*(Footnote continued on following page.)*

## II.

## THE JUDGMENT SHOULD BE AFFIRMED BECAUSE ARTICLE III OF THE CONSTITUTION BARS UNTENURED "JUDGES" SUCH AS THE BANKRUPTCY JUDGE HERE FROM EXERCISING THE JUDICIAL POWER OF THE UNITED STATES.

An additional, threshold reason for affirmance of the judgment of the Tenth Circuit is the bankruptcy judge's lack of jurisdiction and power under Article III of the Constitution to entertain these proceedings. Article III requires that any judge of a federal court who exercises the "judicial power of the United States" shall be guaranteed lifetime tenure (subject only to impeachment) and protection against diminution in salary.[21]

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related exemption sections. 11 U. S. C. § 522(c). House Report No. 95-595, 95th Cong., 1st Sess. (1977). The Tenth Circuit held that retroactivity was compelled because otherwise a "gap" without any applicable law would exist. This argument neglects the fact that the pre-existing law applicable to liens in bankruptcy was based on state law, not any earlier federal enactment. No "gap" exists because prospective-only application of § 522(f) leaves previously-created liens effective under state law. *See Long* v. *Bullard,* 117 U. S. 617 (1886).

[21] Article III provides:

> Section 1. The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.
>
> Section 2. The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made. . . .

Since Congress explicitly denied constitutional tenure and salary protection to the newly independent bankruptcy judges (referees) it created by the 1978 Act, these judges (referees) are incapable of exercising the judicial power of the United States.[22]

This issue is squarely involved in *Northern Pipeline Construction Co.* v. *Marathon Pipeline Co.*, No. 81-150 and *United States* v. *Marathon Pipeline Co.*, No. 81-546 (consol.), on appeal from the order of the district court (Judge Lord), holding the bankruptcy courts invalid under the United States Constitution because in violation of Article III. Beneficial Corporation, parent of appellee here, filed a brief *amicus curiae* in that case in favor of the proposition that the bankruptcy courts can not constitutionally functior unless the judges thereof have the tenure and salary protections of Article III. Reference is respectfully made to that brief for a more complete discussion of the issues here.

A.

**Since the Bankruptcy Court Below Lacked Constitutional Power and Jurisdiction, This Court Should Address the Issue Although Not Previously Raised.**

Although this alternate ground of decision was not raised below, it should now be considered by this Court because it

[22] The tenure of the present referees or "bankruptcy judges" is until March 31, 1984, subject to a decision on continued "qualification" by the Chief Judge of the Circuit Court, Title IV, §§ 404(a), (b), (d), 92 Stat. 2683, and to removal by the district court for "incompetency, misconduct or neglect of duty." *See* former 11 U. S. C. § 62. Their salaries are subject to diminution. Meanwhile they are vested with all of the powers under the Bankruptcy Reform Act. Thereafter, bankruptcy judges are appointed by the President for 14-year terms and Congress may decrease salaries. 28 U. S. C. § 152-154.

involves a fundamental, jurisdictional defect in this proceeding —whether the bankruptcy court, as constituted and empowered under the 1978 Act, can in any event consider the debtors' applications under § 522(f) or the bankruptcy proceedings themselves in view of the fact that the bankruptcy court itself as constituted and empowered under the 1978 Act represents a violation of Article III. *Glidden Co.* v. *Zdanok*, 370 U. S. 530, 536-37 (1962); *Gutierrez* v. *Waterman Steamship Corp.*, 373 U. S. 206, 209 (1963); *McGrath* v. *Kristensen*, 340 U. S. 162, 167 (1950) (Article III jurisdiction involved). Indeed, the question is so fundamental that if not raised by the parties, this Court should consider it on its own motion.

In *Glidden*, for example, the question of whether Article III was violated by designating judges of the Court of Claims and Court of Customs and Patent Appeals to sit on the district court and court of appeals was raised for the first time in the petition for certiorari. Justice Harlan, writing for the Court, said:

> The alleged defect of authority here relates to basic constitutional protections designed in part for the benefit of litigants. *See O'Donoghue v. United States*, 289 U.S. 516, 532-534, 53 S.Ct. 740, 743, 744, 77 L.Ed. 1356. It should be examinable at least on direct review, where its consideration encounters none of the objections associated with the principle of *res judicata*, that there be an end to litigation. At the most is weighed in opposition the disruption to sound appellate process entailed by entertaining objections not raised below, and that is plainly insufficient to overcome the strong interest of the federal judiciary in maintaining the constitutional plan of separation of powers. So this Court has concluded on an analogous balance struck to protect against intruding federal jurisdiction into the area constitutionally reserved to the States: Whether diversity of citizenship exists may be questioned on direct review for the first time in this Court. [Citations omitted.] *We hold that it is similarly open to these petitioners to challenge the constitutional authority of the judges below.*

370 U. S. at 536-7 (emphasis added).

Alternatively, this Court should and must consider the jurisdictional and constitutional question raised by these cases on its own motion. This Court has repeatedly held that where the record discloses jurisdictional defects in lower court proceedings, even if those defects are not raised by a party, this Court will recognize those defects and correct them. See *United States* v. *Corrick*, 298 U. S. 435, 440 (1936); *King Iron Bridge and Mfg. Co.* v. *County of Otoe*, 120 U. S. 225, 226 (1887).

## B.

## The 1978 Act Vests the Article III Judicial Power in Untenured Courts.

### 1.

### The Act Creates Courts Endowed With Full Judicial Powers.

The 1978 Act established "United States Bankruptcy Courts" and Judges with vast and exclusive judicial powers to hear and determine all bankruptcy matters, which matters have throughout our history been heard only by or under the control and supervision of the federal district courts. *See* 28 U. S. C. § 1471(a)-(e). Additionally, these new courts and judges have *unreviewable* discretion to hear any non-bankruptcy matter "related" to a bankruptcy and previously cognizable only in state or federal district courts. 28 U. S. C. §§ 1471, 1473-4, 1478, thereby ousting such courts of their power over these cases.

Thus, under the 1978 Act, the bankruptcy courts and judges have jurisdiction of diverse cases and issues embracing practically the entire *corpus juris*. These will arise in matters of the greatest complexity, ranging from the bankruptcy and reorganization of vast companies, railroads, securities brokers, commodities brokers, municipalities, etc. They will also arise in

cases like the present: such as when determining the existence and validity of security interests and liens under the laws of the 50 States and the territories. For example, in cases like the present the bankruptcy courts and judges will undoubtedly be faced with decisions as to the validity of liens—perhaps, as the government suggests, whether liens were improperly or unlawfully acquired,—and many other questions which involve matters of fact and law that under our system are committed to judicial determination. These are *private* rights; they are not controversies that, under our system of government and the terms of our federal Constitution, can be committed to judges or tribunals who do not meet the fundamental standards set forth in Article III of our Constitution.

A mere listing of the powers explicitly vested in the so-called bankruptcy courts and judges makes clear the vast scope of their authority, and demonstrates that the authority vested in them for exercise, exclusively and without control by a constitutional court, is part of the judicial power of the United States. Thus, under the 1978 Act:

(a) The bankruptcy court "shall have the powers of a court of equity, law, and admiralty," with only minor limitations—injunctions of other courts and criminal contempts warranting jail or committed outside the judge's presence. Parties before other courts can be enjoined. *In re Seeburg Corp.*, 5 B. R. 364 (N. D. Ill. 1980), and full civil contempt powers exist. (28 U. S. C. § 1481.) Judgments of the bankruptcy judge (referee) are final subject only to appellate review. 28 U. S. C. §§ 1482, 160, 1334, 1293.

(b) The bankruptcy court has ample power to enforce its judgments; it may award damages, order specific performance, levy execution, issue injunctions, grant declaratory judgments (28 U. S. C. § 2201), and impose civil contempt judgments.

(c) The bankruptcy judge is given the right to hold jury trials. (28 U. S. C. § 1480.)

(d) A bankruptcy court may issue a writ of *habeas corpus* to bring a person before the court "to perform a duty imposed on such person under this title," or for examination, or to testify, or to order release of a debtor imprisoned under judgment "of a Federal or State court" if he was imprisoned on process in a civil action. (28 U. S. C. § 2256.)

Except for the lack of Article III protections, all distinctions between the new bankruptcy judges (referees) and constitutional judges are expressly obliterated. The new bankruptcy courts are "courts of the United States" and the new bankruptcy judges are "judges of the United States." 28 U. S. C. § 451. Provisions of the United States Code empowering courts and judges of the United States, including the All-Writs provision, accordingly apply. 28 U. S. C. § 1651. The new bankruptcy judges are members of the Judicial Conference of each circuit, with two to participate in the Judicial Conference of the United States. 28 U. S. C. §§ 331, 333. A retired bankruptcy judge may be assigned to perform "such judicial duties within the circuit" as he is willing and able to undertake. 28 U. S. C. § 294(c), including duty on "a court of appeals or district court." 28 U. S. C. § 294(d). *Cf. also* 28 U. S. C. § 295.

Beneficial does not contest that certain functions of an essentially administrative nature associated with bankruptcy could constitutionally be assigned to a non Article III official, but the adjudication of rights to property such as at issue herein do not fall within that category. In fact, the 1978 Act strips the bankruptcy judge of the "administrative" functions of the prior referees and reposes those functions in the trustee. *See, e.g.*, 11 U. S. C. §§ 323, 327, 343, 363, 364. The bankruptcy court is "a true court, unlike specialized administrative tribunals." Report of the House Subcommittee on Civil and Constitutional Rights for the Committee of the Judiciary, H. R. Rep. N. 95-595, 95th

Cong. 1st Sess., *reprinted in* [1978] *U. S. CONG. & ADMIN. NEWS* 5968 ("House Report") at 32. *See also, id.*, at 3-4, 107.

Neither are the new bankruptcy courts "specialized" with respect to their subject matters. Indeed, the fantastic sweep of their jurisdiction shows they fully displace the district courts across a wide expanse of the normal jurisdiction of the district courts.

Neither do considerations of efficiency in the centralization of all matters related to a bankruptcy in one court justify the Act. Centralization would not require ignoring Article III. But in any event the Act requires that a broad range of cases, including as a practical matter the most extensive types, *must* be commenced in the bankruptcy court for the district where venue would have been proper under applicable nonbankruptcy provisions. 28 U. S. C. § 1473(b)-(e). The same is true for removal of a pending "related" civil action. 28 U. S. C. § 1478(a). Thus trustees in bankruptcy will still have to travel to remote forums. The fact that the new Act does *not* centralize litigation in one court starkly reveals that its true purpose is *not* to facilitate disposition of all claims affecting the bankrupt in a single forum, but to create a system of courts circumventing, paralleling, and displacing the federal district court system.

In short, the new bankruptcy courts and judges exercise powers, during the present transition period and thereafter, that are indistinguishable from those possessed by Article III district courts.[23]

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[23] The 1978 Act's creation of a "functionally independent" bankruptcy court system marks a significant departure from the district court's prior control over matters before bankruptcy referees under the 1898 Act, as amended. The 1898 Act required a district court judge to individually refer matters to referees. 30 Stat. 552. This procedure remained under the General Orders adopted in 1939. 305 U. S. 679, G. O. Nos. 1, 12(2). By amendment in 1959, the Act allowed reference by the clerk "unless the Judge or Judges direct otherwise." Act of June 23, 1959, § 3, 73 Stat. 109. In addition, the

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2.

**The 1978 Act Creates a Panoply of Federal Rights, the Adjudication of Which Must Be Vested in Article III Courts.**

Clear as it is that the new bankruptcy courts are "inferior courts" possessing full federal judicial powers, it is also clear that they exercise the "judicial Power of the United States."

The language of Article III is explicit: "the judicial Power of the United States shall be vested . . . in such inferior courts as the Congress may . . . ordain," and that judicial power "shall extend to all cases. . . . arising under . . . the Laws of the United States." These proceedings are based solely on the 1978 Act and derived solely therefrom, and seek an adjudication of the rights of the debtors and others under the provisions of that Act. These cases, therefore, "arise under" the laws of the United States. *Gully* v. *First National Bank in Meridian,* 299 U. S. 109 (1936); *American Well Works Co.* v. *Layne & Bowler Co.,* 241 U. S. 257, 260 (1916); *Romero* v. *International Terminal Operating Co.,* 358 U. S. 354, 381 (1959) (Brennan, J., concurring in part, dissenting in part).

Congress purported to enact the 1978 Act pursuant to its conceded power under Article I, Section 8, "to establish a

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district judge could revise or modify the referee's report or take additional evidence. G. O. No. 47. In the Bankruptcy Rules adopted in 1973, the district court judge's control of matters before his referees shifted from the order of reference and power to rehear evidence to the power to "withdraw a case in whole or a part from a referee" at any time. Bankruptcy Rule 102(b). Additionally, the district judge appointed referees and had the power to remove them for incompetence, misconduct, or neglect of duty. Former 11 U. S. C. § 62(b). But whatever the mechanism of control, until the 1978 Act, Article III district courts maintained power and control over bankruptcy proceedings before referees or bankruptcy "judges." *See, e.g., Weidhorn* v. *Levy,* 253 U. S. 268, 271 (1920); compare *United States* v. *Raddatz,* 447 U. S. 667, 681-2, 685 (1980).

uniform Rule of Naturalization, and uniform laws on the subject of Bankruptcies throughout the United States." But although Congress derives from Article I its power to pass uniform laws on bankruptcies, like its power to pass laws involving interstate commerce, the authority to vest jurisdiction over cases arising under such laws in an "inferior court" of the United States derives solely from Article III. A contrary view, advanced by Justice Jackson, speaking for himself and two others, in *National Mutual Insurance Co.* v. *Tidewater Transfer Co.*, 337 U. S. 582 (1949), was categorically repudiated by six members of the Court. Justice Rutledge, concurring with Justice Murphy in the judgment, affirmed that "[n]or is there merit in the view that the bankruptcy jurisdiction of the district courts does not stem from Article III." 337 U. S. at 611.[24]

Justice Jackson's suggestion that bankruptcy jurisdiction derives from the Article I legislative power, reiterated by the Solicitor General in Nos. 81-150 and 546, is also refuted by the long history, going back 180 years, of vesting bankruptcy jurisdiction in Article III courts. This is especially pertinent because for an equally long period it has been recognized that

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[24] Justice Frankfurter joined by Justice Reed, dissented as to the judgment but concurred with Justice Rutledge on this point, *id.*, at 652 n.3, which was also approved by Chief Justice Vinson and Justice Douglas.

If, based on Article I, Congress could create nontenured inferior courts exercising the judicial power of the United States, the clear and carefully devised tenure and salary protections in Article III could be simply and neatly evaded. It was to avoid this same kind of evasion that this Court recently held that the Article I restriction that bankruptcy laws be "uniform" could not be evaded by basing what the Court held was essentially a non-uniform bankruptcy law upon the Article I commerce power instead. *Railway Labor Executives' Ass'n* v. *Gibbons*, ____ U. S. ____, 50 L. W. 4258 (Mar. 2, 1982). That Congress' Article I bankruptcy power is subject to the rest of the Constitution was pointed out in *Louisville Joint Stock Land Bank* v. *Radford*, *supra* at 539-90.

matters arising outside the confines of Article III judicial power may not be assigned to an Article III court. *Hayburn's Case*, 2 Dall. 409 (1792); *Hodgson* v. *Bowerbank*, 9 U. S. (5 Cranch) 303 (1809); *Gordon* v. *United States*, 117 U. S. 697 (1869).

Incontestably, therefore, the new bankruptcy courts fill all the requirements for Article III courts. They are inferior courts armed with full judicial powers across a broad range of subject matters normally a part of the business of the federal district courts. They exercise the judicial Power of the United States with respect to matters "arising under" federal law, i.e., the bankruptcy laws. The Constitution therefore requires that the judges of these courts hold their offices with the tenure and salary protection set out in Article III, Section 1.

## C.

## No Decision of This Court Has Ever Upheld the Vesting of Article III Power in a Court Lacking Article III's Tenure and Salary Protection.

### 1.

### This Court Has Enforced the Right of Litigants in an Article III Controversy to an Article III Judge.

The basis of Article III is both protection of the rights of litigants to judges "free from potential domination by other branches of government", *United States* v. *Will*, 449 U. S. 200, 217-218 (1980), and also separation of the powers of the federal government. The Justices of this Court have repeatedly enforced the right of a private litigant in an Article III controversy to an Article III judge, and, in addition, have invalidated executive and legislative encroachments onto Article III. As early as 1792, sitting on circuit, Justices Wilson and Blair refused to carry out an Act of Congress because its

provision subjecting court decisions to executive revision was "radically inconsistent with the independence of th[e] judicial power . . . ," which in their view it was the function of the tenure and salary provisions to assure. *Hayburn's Case*, 2 U. S. (2 Dall.) 409, 411 n. (a) (C. C. D. Pa. 1792). Justice Iredell reached the same conclusion on the explicit ground that the statute had unconstitutionally conferred judicial power on the Secretary of War, who did not enjoy Article III protection: "[F]or though Congress may certainly establish . . . courts of appellate jurisdiction, yet such courts must consist of judges appointed in the manner the Constitution requires, and holding their offices by no other tenure than that of their good behaviour, by which tenure the office of Secretary of War is not held." *Id.* at 413 n. (a) (C. C. D. N. C. 1792).

When President Lincoln subjected civilians to trial by military commissions during the Civil War, this Court held that even wartime necessity could not justify disregard for a federal litigant's right to an Article III court. This Court held that "[o]ne of the plainest constitutional provisions was, therefore, infringed when Milligan was tried by a court not ordained and established by Congress, and not composed of judges appointed during good Behaviour." *Ex parte Milligan*, 71 U. S. (4 Wall.) 2, 122 (1867).

As this Court has thus repeatedly affirmed, it is the "duty" of "every federal judge . . . to withstand any attempt . . . to diminish his compensation, not for his private advantage . . . but in the interest of preserving unimpaired an essential safeguard adopted as a continuing guaranty of an independent judicial administration for the benefit of the whole people." *O'Donoghue* v. *United States*, 289 U. S. 516, 533 (1933).

2.

**This Court's Decisions Do Not Permit the Transfer of Bankruptcy Cases to Untenured Tribunals.**

As two Justices of this Court recently observed:

> Congress has never attempted to displace Art. III courts when laws of nationwide applicability were involved, and nothing in our prior decisions suggest that it may constitutionally do so.

*United States* v. *Raddatz*, 447 U. S. 667, 706 (1980) (dissenting opinion of Marshall, J., joined by Brennan, J.).

The 1978 Act would accomplish precisely this forbidden end. It would do so contrary to the recommendation of the only Congressional subcommittee to study the matter at length, which concluded that placing bankruptcy matters in untenured courts could not pass constitutional muster. House Report, at 39.[25]

A brief analysis of this Court's decisions will confirm that, where the distinctively judicial power of the United States is implicated, as opposed to areas primarily committed to disposition by the Executive or Legislative branches, the requirements of Article III have been unalterably maintained. The decisions permitting untenured federal judges have involved only matters or geographical areas constitutionally committed, under our system of limited and separate federal powers, to the other, non-judicial branches of government. We respectfully refer the Court to the "Brief for Amicus Curiae Beneficial Corporation," at pp. 14-30, in *Northern Pipeline Construction Co.* v. *Marathon Pipeline Co.*, Nos. 81-150 and 81-546, for a more detailed analysis of these cases.

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[25] That the Reform Act as ultimately passed provided for non-constitutionally tenured judges, although the House had recommended and provided for Article III judges, was the result of a last-minute compromise by floor managers to satisfy the wishes of the chairman of the Senate Judiciary Committee. *See* 124 CONG. REC. H 11,866 (daily ed. Oct. 6, 1978) (remarks by Rep. Don Edwards).

a.

## The Scope of Article III.

Article III provides a broad protection for all citizens against the combination of executive or legislative with judicial power at the federal level. Its scope is only bounded by its purposes.

Article III is one-third of the tripartite division of federal power into executive, legislative, and judicial branches. Following Montesquieu,[26] the Framers understood these divisions did not create airtight compartments. Nonetheless, a core of distinctively judicial, executive and legislative powers was exclusively reserved to each. *See Buckley* v. *Valeo*, 424 U. S. 1, 132-33 (1976).

The structure of the Constitution reflects the Framers' twin paramount concerns: (1) that within the states the "judicial Power of the United States," as with the executive and legislative powers, be limited and defined,[27] and (2) that the essential and distinctively "judicial Power of the United States" not overreach and infringe upon the distinctively executive and legislative, nor they with the judicial.[28] Article III was not

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[26] *See, e.g., The Federalist*, No. 9 (A. Hamilton); 47 (J. Madison); 78 (A. Hamilton); Montesquieu, *The Spirit of Laws*, book XI, § 4. *See* Krattenmaker, *Article III and Judicial Independence*, 70 Geo. L. Rev. 297, 302 (1981).

[27] At the Constitutional Convention in Philadelphia, many were distrustful of a federal judiciary at all and objected to the creation of any inferior federal courts, believing state courts should decide all federal cases. *National Mutual Ins. Co.* v. *Tidewater Transfer Co.*, 337 U. S. 582, 632, 647 (1949) (Opinions of Rutledge, J., concurring; Frankfurter, J., dissenting).

[28] Thus the American colonists were determined not to permit "[t]he accumulation of all powers, legislative, executive and judiciary, in the same hands. . . ." *The Federalist*, No. 47 (J. Madison) 324 (J. Cook ed. 1961). *See O'Donoghue* v. *United States*, 289 U. S. 516, 531 (1933).

concerned with the exercise of federal power *outside* the states, nor with the exercise of power which was not peculiarly *judicial* but rather was within the province of the executive or legislative branches. Given this predicate, the prior decisions of this Court are wholly consistent with Article III.

**b.**

**Territorial Courts and the District of Columbia.**

The establishment of non-Article III courts in the territories of the United States does not involve the vesting of the judicial power defined by Article III because the Constitution commits to Congress exclusive and sole power over the territories—the "combined powers" of a federal and state government. *American Insurance Co.* v. 356 *Bales of Cotton (Canter)*, 26 U. S. (1 Pet.) 511, 546 (1828). This total sovereignty is both inherent and is expressly found in the Territorial clause (Article IV, § 3). It is not limited by separation of powers, but only by the fundamental individual rights found in the Bill of Rights. *See, e.g., Balzac* v. *Porto Rico*, 258 U. S. 298 (1922).

The same principle supports the creation of non-Article III courts in the exclusive federal enclave consisting of the District of Columbia. *Palmore* v. *United States*, 411 U. S. 389, 407 (1973) (purely local courts were created pursuant to the total sovereignty of federal and "a state government").

**c.**

**Matters Committed to Other Branches: the Court of Claims and Customs Court.**

The decisions of this Court dealing with the Court of Claims and the Customs Court rely on the fact that the matters committed to the Court of Claims and the Customs Court did not necessarily fall within the distinctively *judicial* power at all. The point was shown in the early case of *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U. S. (18 How.) 272,

277 (1856) (direct action by the Treasury to levy on public monies from a defaulting customs collector fell outside Article III), in which the Court pointed out that there had been "no period since the establishment of the English monarchy" when a "summary method for recovery of debts due to the Crown" had not existed.

In the case involving the so-called "Court of Customs and Patent Appeals," *Ex Parte Bakelite Corp.*, 279 U. S. 438, 458 (1929), this Court similarly pointed out that the determination of customs matters involved "nothing which inherently or necessarily requires judicial determination, but only matters the determination of which may be, and at times has been, committed exclusively to executive officers." *See also Williams* v. *United States*, 289 U. S. 353 (1933) (Court of Claims).

This distinction makes eminent sense in terms of the purposes of Article III, for the claim of a right to a decision uninfluenced by Congress or the Executive is obviously less compelling when those branches could have made the decision in the first place. Thus the basis of *Murray's Lessee* and *Bakelite* was that Congress could leave the customs matters to a nontenured "court" because it could have, and historically always had, sidestepped the courts altogether.

Matters thus committed to the exclusive discretion of the legislative or executive branches do not implicate the judicial power. On the other hand, Congress can choose to vest decision power over these matters in Article III courts by provisions that make the exercise of judicial power appropriate; for example, by creating rights which can be finally adjudicated by judicial process without legislative or executive intervention. *See Murray's Lessee, supra* at 284 ("public rights" may be presented in a form in which the judicial power is capable of acting).

Bankruptcy cases, however, involve adjudications of purely *private* right between debtors and creditors and among creditors. As the seminal article in this field states: "it would seem

that bankruptcy matters and patent infringement suits could not be committed to legislative courts, since these matters have never been considered as susceptible of final determination by executive officers." Katz, *Federal Legislative Courts,* 43 Harv. L. Rev. 894, 916 (1930).

**d.**

**Military Courts.**

For similar reasons, military courts-martial are not vested with constitutional judicial power. Courts-martial are created by virtue of the historic and fundamental sovereign power over the military, vested by the Constitution in the President as Commander in Chief and in the Congress. *Dynes* v. *Hoover,* 61 U. S. (20 How.) 65, 79 (1858) (trial of servicemen for service offenses by *ad hoc* courts-martial upheld; Congress' power over military punishment "is given without any connection between it and the 3d article of the Constitution. . . .") *See also, Ex parte Milligan,* 71 U. S. (4 Wall.) 2, 122 (1867). This Court has, moreover, carefully and narrowly confined the jurisdiction of the military courts. *See United States ex rel. Toth* v. *Quarles,* 350 U. S. 14, 15-16 (1955) (extension of military court jurisdiction to discharged servicemen "necessarily encroaches on the jurisdiction of federal courts set up under Article III . . . ."); *O'Callahan* v. *Parker,* 395 U. S. 258 (1969) (military court may not try a serviceman's non-service connected crime).

**e.**

**Administrative Agencies.**

Congress' power to vest certain adjudicatory functions in administrative agencies does not justify the creation of untenured courts. As has been recognized at least since the decision in *Murray's Lessee, supra,* 59 U. S. (18 How.) at 280-81, not all "adjudicatory functions" are necessarily exercises of "judicial

power"; preliminary determinations of fact and law, without coercive or enforcement power, may in appropriate settings fall within the executive or legislative domain. In fact, the "adjudicatory" functions of administrative agencies are limited, and do not extend to the core judicial power. Such agencies are not the delegates of a roving commission to try cases and enforce their judgments; in fact they may not constitutionally do so. *ICC* v. *Brimson*, 154 U. S. 447, 485 (1894). *See also Crowell* v. *Benson*, 285 U. S. 22 (1932) (administrative agency had no power to enforce its own award, only to investigate and make factual findings).[29]

By contrast, the non-Article III judges and courts under the 1978 Act are given full judicial power to decide controversies and to enforce their orders. The bankruptcy courts' powers are not like the powers of administrative agencies; they are judicial in form and fact. They can issue execution and levy, they can punish civil contempts, issue writs of *habeus corpus* and perform all the acts of a court.

But it is unnecessary and irrelevant to consider whether Congress could constitutionally employ an administrative scheme rather than a federal court for the adjudication of bankruptcy matters because the fact is that Congress has not done so. It has chosen to vest bankruptcy jurisdiction in a court with full judicial powers, endowed with all the attributes of an Article III court save only the guarantees of tenure and compensation. The plain meaning of Article III is that if Congress elects to vest judicial power in an "inferior court" it must do so in a court having the attributes prescribed by Article III.

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[29] Moreover, administrative agencies not only lack "judicial power," they are also restricted to areas where "public rights" involving matters "between the government and others" are involved. *Atlas Roofing Co.* v. *Occupational Safety & Health Reivew Comm'n*, 430 U. S. 442, 455 (1977).

f.

**The Bankruptcy Court Cannot Be Sustained as a Delegation of Judicial Power in View of *United States* v. *Raddatz*.**

In *United States* v. *Raddatz*, 447 U. S. 667 (1980) (district court not required to rehear witness before magistrate on a suppression motion), this Court set forth the protections which must be available in order to render a delegation of Article III judicial power to untenured personnel constitutional.

The dramatic contrast between the limited powers of a magistrate and full powers of the bankruptcy judges (referees) under the 1978 Act is shown by Mr. Justice Blackmun's summary:

> The handling of suppression motions invariably remains completely in the control of the federal district court. The judge may initially decline to refer any matter to a magistrate. When a matter is referred, the judge may freely reject the magistrate's recommendation. He may rehear the evidence in whole or in part. He may call for additional findings or otherwise "recommit the matter to the magistrate with instructions." . . . Moreover, the magistrate himself is subject to the Article III judge's control. Magistrates are appointed by district judges, § 631(a), and subject to removal by them, § 631(i). In addition, district judges retain plenary authority over when, what, and how many pretrial matters are assigned to magistrates . . . . Thus the only conceivable danger of a "threat" to the independence of the magistrate comes from within, rather than without, the judicial department.

447 U. S. at 685 (concurring opinion).

The contrast with the new bankruptcy courts could not be more extreme. Under the changes made by the 1978 Act, no control remains in the district court over the activities of a bankruptcy judge (referee) such as exists over those of a magistrate (or a master). The bankruptcy court's powers and attributes, described earlier, are in every material respect the

opposite of a magistrate's (or a master). Purposefully made completely independent of the control of the district court judges, the new bankruptcy judges (referees) nonetheless have all their powers.

In sum, congressional power to legislate on the subject of bankruptcies cannot and does not destroy the right of the people, provided in Article III, to an independent judiciary for the resolution of private disputes in federal court. To allow Congress to circumvent through Article I, limitations on its powers found in Article III "would be to sap the judicial power as it exists under the federal Constitution, and to establish a government of a bureaucratic character alien to our system. . . ." *Crowell* v. *Benson*, 285 U.S. 22, 57 (1932).

## CONCLUSION

Appellee respectfully submits that the decision below is clearly correct in holding that § 522(f) of the Bankruptcy Reform Act of 1978, applied retroactively in these cases to liens perfected and vested prior to the enactment of the Act, is unconstitutional under the Fifth Amendment of the Constitution of the United States.

Appellee further submits, however, that the Court should affirm the decision below on the fundamental and threshold ground that the Act is unconstitutional because it vests the judicial power of the United States, essential for administration of the Act, in so-called bankruptcy courts and judges who do not conform with the requirements of Article III of the Constitution. It is, of course, clear that if the provisions for administering the Act—that is, the bankruptcy courts and judges—are unconstitutional, the Act as a whole cannot be administered; and indeed, the Congress did not include a separability clause in the Act, but on the contrary, made clear

its intention that the "judicial" provisions of the Act were "at the heart of the bill".[30]

We suggest to the Court that if the Bankruptcy Reform Act of 1978 is held to be unconstitutional, all the provisions of the Bankruptcy Act of 1898, as amended, will become operative, to be administered by the district courts of the United States in accordance with the provisions that were in effect prior to the 1978 Act. *See, e.g., Frost* v. *Corporation Comm'n*, 278 U. S. 515 (1929); *Conlon* v. *Adamski*, 77 F. 2d 397, 399 (D. C. Cir. 1935); *Weissinger* v. *Boswell*, 330 F. Supp. 615 (M. D. Ala. 1971). Approximately 97,938 cases pending are still being adjudicated under the provisions of the 1898 Act, as amended. Pub. L. 95-598, Title IV, § 403(a), 92 Stat. 2683. *Annual Report of Director, Admin. Office of U.S. Courts* (June 30, 1981). Decrees and decisions made and entered under the 1978 Act need not be affected by the Court's decision, which can operate prospectively only, and pending proceedings can readily be transferred without hiatus for administration under the terms of the prior Bankruptcy Act.[31] Congress can then

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[30] Congressman Edwards (principal author of the bill), 123 Cong. Rec. H. 11,699 (daily ed., Oct. 27, 1977). Congressman Rodino, chairman of the House Judiciary Committee reporting out the bill, stated that "the most significant portion of the bill concerns the way bankruptcy cases are handled." *Id.* at 11,697. Congressman McClory, a member of the Subcommittee, stated: "[W]e are empowering them [the bankruptcy judges] to handle the kind of work we want them to handle. It cannot be done with the old machinery. We cannot handle the new business in an old way." 123 Cong. Rec. H. 11,774 (daily ed., Oct. 28, 1977).

[31] A holding of unconstitutionality would not subject prior judgments under the 1978 Act to collateral attack for the reasons set forth in *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U. S. 371, 374 (1940); *Accord, Linkletter* v. *Walker*, 381 U. S. 618, 627 (1965). Furthermore, the three factors cited in *Chevron Oil Co.* v. *Huson*, 404 U. S. 97, 106 (1971), strongly suggest that such a decision can be made prospective only to avoid potential hardship in a matter of first impression. *See, e.g., Kirchberg* v. *Feenstra*, 609 F. 2d 727, 735-36 (5th Cir. 1979), *aff'd*, 450 U. S. 455 (1981).

proceed, if it sees fit, to reconsider the Bankruptcy Act and any amendments thereof it deems to be appropriate in compliance with the decision of this Court.

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# Supplemental Brief

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IN THE

# Supreme Court of the United States

October Term, 1982

UNITED STATES OF AMERICA,

*Appellant,*

*v.*

SECURITY INDUSTRIAL BANK, BENEFICIAL FINANCE OF KANSAS, INC., ET AL.,

*Appellees.*

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## SUPPLEMENTAL BRIEF OF APPELLEE BENEFICIAL FINANCE OF KANSAS, INC.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1982

UNITED STATES OF AMERICA,

*Appellant,*

v.

SECURITY INDUSTRIAL BANK, BENEFICIAL FINANCE OF KANSAS, INC., ET AL.,

*Appellees.*

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## SUPPLEMENTAL BRIEF OF APPELLEE BENEFICIAL FINANCE OF KANSAS, INC.

### STATEMENT

Appellee Beneficial Finance of Kansas, Inc. ("Beneficial") respectfully submits this Supplemental Brief pursuant to Rule 35.5, in light of this Court's intervening decisions in *Loretto v. Teleprompter Manhattan CATV Corp.*, ____ U.S. ____, 102 S.Ct. 3164 (June 30, 1982), and *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, ____ U.S. ____, 102 S.Ct. 2858 (June 28, 1982), handed down since submission of our principal brief last term.

In *Northern Pipeline*, this Court agreed with the position previously set out herein, that Article III of the U.S. Constitution — which guarantees independence of the federal judiciary by life tenure and irreduceable salary — was violated by the 1978 Bankruptcy Act's creation of separate courts staffed by so-called "bankruptcy judges" (the former bankruptcy referees) lacking

those guarantees. This Court properly held the 1978 Act's unconstitutional jurisdictional grant to these bankruptcy courts to be inseverable. To avoid upsetting previously settled matters, this Court held its decision to operate prospectively only, and to avoid impairing the interim administration of the bankruptcy laws and to afford Congress time to enact curative legislation, this Court stayed its judgment until October 4, 1982.

If Congress does *not* so act, the question arises as to whether the courts can administer bankruptcies pending further action by Congress and, if so, under what bankruptcy law. Concern is principally for the orderly functioning of the bankruptcy system within constitutional and existing statutory constraints.

Appellees respectfully submit that the 1978 Act was set up to be exclusively administered by its unconstitutional bankruptcy court system, and that it was intended *not* to be administered and can *not* properly be administered by the district courts of the United States. Until Congress can enact a new and constitutional bankruptcy law, the prior bankruptcy law revives, because repeal of a prior law is ineffective if the repeal is part of a substitute enactment which is itself ineffective. The Bankruptcy Act of 1898 (as amended), was in fact continued in effect by the 1978 Act for all then pending cases — at last count almost one-fifth of all present pending bankruptcy cases. Revival of the prior Act for the remaining cases allows the continued functioning of the bankruptcy system by the existing cadre of referees (judges) under a set of known and broadly similar rules and provisions, without endless litigation and consequent harmful delays in bankruptcy administration, and without burdening the district court judges. Revival can be prospective only, so parties in pending cases who relied upon existing law will not be injured and decided matters remain as decided.

Because this case raising this issue was pending in this Court simultaneously with *Northern Pipeline*, the rule of *Northern Pipeline* applies here. *Linkletter v. Walker*, 381 U.S. 618, 627, 85

S.Ct. 1731 (1965). And since the bankruptcy judge (referee) below had jurisdiction hereof under the provisions of the prior act, and that act protected Beneficial's liens, the complaint to avoid lien herein was properly dismissed on this alternative ground.

In addition, this Court's intervening decision in *Loretto v. Teleprompter Manhattan CATV Corp.*,___ *U.S.* ___, 102 S.Ct. 3164 (1982), holding that a law which required a landlord to allow cable TV facilities to be installed on his premises effected an unconstitutional taking *per se*, strongly underlines Beneficial's contention that the complete destruction of its preexisting security interest in property by a provision of the 1978 Act also effects a *per se* unconstitutional taking in violation of the Constitution, regardless of the nature of that property or the partially beneficent motives of Congress in permitting such destruction.

## ARGUMENT

### I.

### BECAUSE THE REMAINING PROVISIONS OF THE BANKRUPTCY REFORM ACT OF 1978 WERE NOT INTENDED TO FUNCTION AND CANNOT PRACTICALLY BE MADE TO FUNCTION APART FROM THE BANKRUPTCY COURT SYSTEM HELD UNCONSTITUTIONAL IN *NORTHERN PIPELINE*, IN THE ABSENCE OF CURATIVE CONGRESSIONAL ACTION THE ENTIRE 1978 ACT FALLS, AND THE PRIOR BANKRUPTCY ACT REVIVES PENDING FURTHER CONGRESSIONAL ENACTMENT.

In *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, ___ U.S. ___, 102 S.Ct. 2858 (June 28, 1982), this Court held that the jurisdiction and powers vested by §241(a) of the Bankruptcy Reform Act of 1978 in the so-called "bankruptcy courts" violated the judicial article of the Constitution, which guarantees independence of the judiciary — through life tenure and irreduceable salary — from domination by the political branches. It is Beneficial's contention that, in the absence of

appropriate curative action by Congress, the remainder of the 1978 Act cannot stand, including 11 U.S.C. §522(f), upon which the present controversy rests.[1] The consequence of such a holding (which may be made prospective only) is that the prior Bankruptcy Act now becomes operative to govern all bankruptcies, including that here. Since the 1898 Act, as amended, protected Beneficial's liens, the proceedings here to avoid those liens were properly dismissed.

**A. The 1978 Act was not intended to be administered and is not administrable apart from the unconstitutional judicial provisions contained in section 241(a).**

If an act of Congress is partially invalid and cannot properly function apart from the invalid portion, the entire act falls; it is not for the courts to attempt to reconstruct the failed Congressional design. To enforce only part of an integrated statute "would be to create a program quite different from the one the legislature actually adopted." *Sloan v. Lemon*, 413 U.S. 825, 834, 93 S.Ct. 2982 (1973) (rejecting partial enforcement of a Pennsylvania tuition reimbursement statute, despite the presence of a severability clause). For courts to attempt to patch and reconstruct Congressional enactments endangers the fundamental division of function between appropriate judicial and legislative activities. *Cf., Buckley v. Valeo*, 424 U.S. 1, 120-23, 96 S.Ct. 612 (1976).

In the present instance, the available evidence confirms that Congress did not intend the 1978 Act to be administered, nor can it be administered, apart from the unconstitutional bankruptcy

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1. This Court's decision in *Northern Pipeline* applies to Beneficial, despite the prospective nature of the *Northern Pipeline* holding, because the issue had already been raised by Beneficial in a case "on direct review" with this Court. *Linkletter v. Walker*, 381 U.S. 618, 627, 85 S.Ct. 1731 (1965). *See* Jurisdictional Statement in No. 81-583, *Beneficial Finance of Kansas v. United States*, and Beneficial's Brief in this case, No. 81-184.

court system created to administer it. The 1978 Act contains no severability clause. The unconstitutional judicial system was clearly one of the two most significant aspects of the bill,[2] and provided its exclusive means of enforcement. The Act was specifically designed *not* to be administered by the district court judges.

If Congress does not act, three possibilities exist: (1) the existing district court judges will be left with the extraordinary task of trying to apply the remainder of the Act to pending and future bankruptcies; (2) no bankruptcy law will apply at all;[3] or (3) the 1978 Act as a whole falls, allowing the prior Act to govern all bankruptcies pending further action by Congress. For reasons to be discussed, possibilities (1) and (2) disregard the manifest Congressional design and imply needless chaos. The third possibility — revival of the 1898 Act, as amended — is supported by logic and precedent and appears to be the best practical alternative — in fact perhaps the only appropriate alternative for this Court.

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2. The other primary goal, an enhanced fresh start for the debtor, is discussed at pp. 13-14 *infra*.

3. For long periods of our country a *federal* bankruptcy law was considered neither inevitable nor desirable. *See generally* C. Warren, *Bankruptcy in United States History* (1935). The first three Bankruptcy Acts, covering the periods 1800-1803, 1841-1843, and 1867-1878, were each enacted during brief periods of depression or financial panic, and were speedily repealed. *See* Olmstead, *Bankruptcy, A Commercial Regulation*, 15 Harv.L.Rev. 829 (1902). For most of the last century, principal responsibility for debtor relief lay with the states, which enacted exemption laws and various temporary "stay laws," whose purpose was to prevent creditors from bringing immediate action against insolvent debtors. *Id.* With respect to consumer debtors' "fresh start", the states are still the principal source of relief, even after the 1978 Act. *See* Appendix A and discussion at p. 14, infra.

**1. The legislative history of the Bankruptcy Reform Act of 1978 shows that its judicial provisions were essential to its passage.**

While establishing legislative intent is often elusive, that task is greatly aided here because the judicial provisions of the 1978 Act were so central to that bill; in fact the congressional debates focused extensively upon those provisions, almost to the exclusion of the other provisions. *See, e.g.*, 123 Cong. Rec. H 11,690-92, H 11,696-710 (daily ed. Oct. 27, 1977); 123 Cong. Rec. H 11,732-83 (daily ed. Oct. 28, 1977); 124 Cong. Rec. H 457-78 (daily ed. Feb. 1, 1978).

As these debates made clear, the overarching problem in bankruptcy administration is the rapid deterioration in asset values during the period after filing.[4]

That is why the court system was the focus of the bill, and why change in the court system was one of the two principal areas of change from prior law. As an earlier Congressional report stated:

> . . . Delay is critical in cases under the Bankruptcy Act, particularly in the business cases where litigation is most likely to occur. This is true because of the prejudicial effect it might have on prospects for rehabilitating

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4. The legislative record stressed that:

> While all litigation should be expeditiously terminated, by the nature of bankruptcy, assets are deteriorating in value. The faster a case is terminated, the more creditors will receive. Both the Congress and the Supreme Court have recognized this at least since the 1840's. Moreover, in a reorganization case, speed is essential to success: Creditors will not wait for a company to reorganize, but will favor liquidation, with the consequent loss of jobs and investments.
>
> *Report of the Subcommittee on Civil and Constitutional Rights of the Committee of the Judiciary*, H. Rep. 95th Cong., 2nd Sess., 34, on hearings on the court administrative structure for bankruptcy courts. Dec. 12, 13, 14, 1977, Committee Print No. 13, Jan. 1978. ("House Report")

> an enterprise in financial distress and the aggravated risk of deterioration of the estate in the course of liquidation.

*Communication from the Executive Director, Commission on the Bankruptcy Laws,* transmitting a report of the Commission on the Bankruptcy Laws, July 1973, 93rd Cong. 1st Sess., H.R. Doc. No. 93137 Part I Sept. 6, 1973.

The objective of the 1978 Act was to create independent bankruptcy courts in an effort "to make bankruptcy procedures more efficient," and enhance the ability to marshall and realize on assets. S. Rep. No. 95-1106, 95th Cong. 2d Sess. 3 (1978). As the House Subcommittee responsible for reporting out the bill summarized:

> The Bankruptcy Commission found, and hearings before the Subcommittee on Civil and Constitutional Rights confirmed, that the most severe problem in the bankruptcy administration was the court system... This bill gives the bankruptcy court the independence it needs to operate in today's complex bankruptcy world.

House Report at 4.

As a result, the 1978 Act created integrated bankruptcy provisions which depended upon the unconstitutional bankruptcy courts, vested with enormous powers, for their administration. The proposed court system was expressly linked to effectuating the Act's remaining provisions. As Congressman Volkmer noted, "The upgraded court system is essential to the proper operation of the bill." 123 Cong. Rec. H 11,705.

The 1978 Act was precisely and expressly designed *not* to be administered by the district courts under any circumstances. In fact, at one point during the debates on the 1978 Act, an amendment was offered by Congressmen Danielson and Railsback which would have eliminated the separateness and broad independent jurisdiction of the bankruptcy courts while retaining the

remaining provisions of the bill. *Id.* at H 11,764-5. This amendment was ultimately overwhelmingly rejected. 124 Cong. Rec. H 472-474 (daily ed. Feb. 1, 1978). Congressman McClory, a member of the House Subcommittee reporting out the bill, perhaps best summarized Congressional reaction when he said:

> We are empowering them to handle the kind of work we want them to handle. It cannot be done with the old machinery. We cannot handle the new business in an old way. 123 Cong. Rec. H 11,774.

The Danielson/Railsback amendment was vigorously opposed by other leaders on the bill. Congressman Rodino, chairman of the House Judiciary Committee responsible for reporting out the bill, stated that "the most significant portion of the bill concerns the way bankruptcy cases are handled." *Id.* at H 11,697. Congressman Edwards, chairman of the Subcommittee on Civil and Constitutional Rights and prime author of the bill, remarked that "the new court system...is at the heart of the bill." *Id.* at H 11,699. Congressman Butler, the ranking minority member of the subcommittee, stated that: "This bill serves no purpose whatsoever if the independence of the bankruptcy courts is removed." *Id.* at H 11,703.

Thus the legislative record discloses the key and signal significance of the new and unconstitutional bankruptcy courts to the functioning of the 1978 Act as a whole. Examination of the Act reveals that this intention was so carried out that any attempt to patch together the remainder without the invalid central piece would be inappropriate and destructive to the continued functioning of the bankruptcy system.

**2. The 1978 Act cannot be administered apart from its unconstitutional judicial system without endless litigation and judicial legislating.**

The practical difficulty of applying the remaining portions of partially invalid statutes weighs heavily in favor of a finding that the entire act falls. *United States v. Jackson*, 390 U.S. 570, 585, 88 S.Ct. 1209 (1968); *compare Electric Bond & Share Co. v. Securities & Exchange Commission*, 303 U.S. 419, 434-35, 58 S.Ct. 678 (1938).

In the absence of a constitutional bankruptcy court, yet to be created by Congress, the only courts available to administer the 1978 Act would be the United States District Courts. But examination of the 1978 Act reveals that there appear to be numerous obstacles to any judicial attempt to transfer bankruptcy administration under the provisions of the 1978 Act to the district courts. For example, the 1978 Act grants *exclusive* jurisdiction over all property of the debtor, "wherever located," to the bankruptcy court alone. 28 U.S.C. §1471(e). This provision carried out Congress' intention that the district courts not administer bankruptcies under the 1978 Act. See 1 *Collier on Bankruptcy*, ¶3.01 (15 ed. 1980). Consequently, absent "artful" reconstruction, the district courts would be powerless to acquire jurisdiction over the property of the estate. Acquisition of such power is a *sine qua non* of effective bankruptcy administration; without it the court cannot protect the debtor's property from creditors.

At the most mechanical level, moreover, the 1978 Act requires that a bankruptcy case be initiated by the filing of an appropriate petition "with the bankruptcy court." 11 U.S.C. §§301-304. This filing defines the estate to be administered and triggers the automatic stay. 11 U.S.C. §§362-363. In the face of Congress' repeatedly expressed intent in the 1978 Act to remove bankruptcy under that Act from the domain of the district courts, it is difficult to see how these sections could be construed to permit filings with the district court.

Other key provisions, such as the pervasive provision allowing judicial action only "after notice and a hearing" (found in 64 sections of the 1978 Act), require the active participation of all creditors and power over all the estate's assets. *See, e.g.*, 11 U.S.C. §§102(1), 363(b), 364(b) and (d), 366(b), 543, 725. These provisions assume complete jurisdiction in the bankruptcy court over all a debtor's assets and over all potential claimants. Endless litigation would be involved in any attempt to apply provisions like these without their assumed jurisdictional and procedural basis. *See, generally*, Novellino, "*After Notice and a Hearing*," 55 Amer. Bankr. L.J. 293 (1981).

Moreover, it is difficult to comprehend how the 1978 Act could be administered through the district courts even if the foregoing problems could somehow be overcome.

The district judges, already swamped by a record number of over 190,000 civil and criminal cases, certainly have no time to administer an additional over half million bankruptcy cases, many involving complex contested state and federal issues. *Ann. Report of Director, Admin. Office of U.S. Courts* (June 30, 1981). Yet any attempt to employ the existing corps of bankruptcy referees (sometimes referred to as "judges" since 1973), appointed under the former Bankruptcy Act, to adjudicate cases under the 1978 Act, is barred because their exercise of the new powers and jurisdiction vested in them by the 1978 Act was precisely what was found unconstitutional and struck down by this Court in *Northern Pipeline*. *See* Pub.L. No. 95-598, Title IV (Transition) §§404-405. Nor can these referees exercise the more limited powers they enjoyed under the prior Bankruptcy Act, because those provisions were repealed by the 1978 Act, except with respect to proceedings commenced prior to October 1, 1979. Pub.L. No. 95-598, Title IV (Transition) §§401, 403(a), 404(d).

Perhaps the district courts could appoint the referees to serve as "masters" or "magistrates" on an emergency basis under existing provisions. *See* Fed.R.Civ.P. 53; 28 U.S.C. §361, *et seq.*

But the powers of a master or magistrate are quite limited both constitutionally and by Rule, *see United States v. Raddatz*, 447 U.S. 667, 100 S.Ct. 2406 (1980); *Northern Pipeline*, *supra*, 102 S.Ct. at 2875-76, with the trial judge retaining ultimate responsibility for all decisions. Thus, the burden of the huge bankruptcy caseload would be placed squarely on the existing district court judges themselves. Moreover, numerous laws, such as the Speedy Trial Act for criminal cases, give priority to certain other classes of cases, leaving bankruptcy cases trailing in the dust. *See, e.g.*, 18 U.S.C. 3161. In sum, any such approach would result in interminable delay, rendering the bankrupt entities moribund and paralyzing the federal courts. It would also spawn endless litigation over the proper "interpretation" or integration of the 1978 Act with existing statutes, completely contrary to Congress' avowed goal of reducing bankruptcy litigation of a technical or jurisdictional nature. Consequently, it seems that any effort to graft the remainder of the 1978 Act on to the existing district court system would constitute an administrative and judicial nightmare. Clearly this was not the intent of Congress when it passed the 1978 Act.

Both the legislative record of the 1978 Act and the technical interdependency of its substantive, procedural, and judicial provisions compel the conclusion that the 1978 Act cannot be administered apart from the unconstitutional means created by Congress. Consequently, the entire act must fall, allowing bankruptcies to be administered according to the prior bankruptcy law from here on until Congress can act. Such a holding can be prospective only in order to protect the legitimate expectations of present litigants and preserve the finality of decided matters in pending and concluded cases. *See*, *Northern Pipeline*, *supra*, 102 S.Ct. at 2880 (plurality), and at 2882 (Rehnquist, J., and O'Connor, J., concurring).

**B. The prior Bankruptcy Act of 1898, as amended, revives during the interim period until Congress legislates anew; since that statute protected Beneficial's liens, the proceeding was properly dismissed.**

The fact that the entire Bankruptcy Reform Act of 1978 falls because it cannot be successfully administered apart from its unconstitutional judicial system does not deprive our country of a national bankruptcy law. An elementary rule of statutory construction provides that the prior law, the Bankruptcy Act of 1898, as amended, ineffectively repealed and supplanted by the 1978 Act, will revive to fill the vacuum until Congress is able to agree upon a new and constitutional bankruptcy law. *Frost v. Corporation Comm'n*, 278 U.S. 515, 526, 49 S.Ct. 235 (1929); *Weissinger v. Boswell*, 330 F.Supp. 615 (M.D. Ala. 1971); *Conlon v. Adamski*, 77 F.2d 397 (D.C. Cir. 1935); *see also State v. Rondeau*, 89 N.M. 408, 553 P.2d 688 (1976); *Fiorito v. Jones*, 39 Ill.2d 531, 236 N.E.2d 698 (1968); *State v. Kolocotronis*, 73 Wash. 2d 92, 436 P.2d 774 (1968); *Cayo v. City of Milwaukee*, 165 N.W.2d 198 (Wis. 1964); 1A Sutherland, *Statutes and Statutory Construction* §23.24 (4th ed. 1972). As stated in *State v. Rondeau, supra*, in which the New Mexico Supreme Court held that the unconstitutionality of a death penalty statute revived its repealed predecessor, "During the interim between the declaration of the statute's unconstitutionality and a new enactment by the Legislature which meets constitutional standards, the former statute is revived and becomes effective without any formal act by the Legislature, absent a contrary legislative intent." 553 P.2d at 692-93.

Consequently, this case, and all future cases, should be governed by the Bankruptcy Act of 1898, as amended, until further direction from Congress. Decided matters in pending cases can remain as decided under then existing provisions. Since the 1898 Act, as amended, protected Beneficial's liens, and as appellant

here that law applies to Beneficial, the complaint below was properly dismissed. *Linkletter* v. *Walker*, 381 U.S. 618, 627, 85 S.Ct. 1731 (1965).

Revival of the prior Act allows a continuity of administration for all bankruptcy cases by the existing cadre of referees (judges) under broadly similar rules and procedures to those in the 1978 Act.[5] Indeed, Congress' two principal goals in the 1978 Act will not be substantially compromised by this result. These two goals were (1) to create a new system of federal courts exclusively to adjudicate bankruptcies and related matters and (2) to enhance the individual consumer debtor's "fresh start" by liberalizing then existing (state) levels of exemptions. As the House Report stated:

> The most severe problem in the bankruptcy administration was the court system. . . . The second major problem under current bankruptcy law is the inadequacy of relief that the Bankruptcy Act provides for consumer debtors.

House Report No. 4.

The first goal has already foundered on Congress' failure to heed the constitutional warnings ultimately embodied in this Court's *Northern Pipeline* decision, and is not implicated in revival of the prior Act.

The second goal — enhancing a debtor's "fresh start" — is also not substantially affected by the prior Act's revival. Congress implemented this goal principally by creating a set of new and liberal federal exemptions, which, however, the states could "opt out" of by legislation so specifying. 11 U.S.C. §522. Ironically, however, exercise of the "opt out" provision has resulted in simultaneous upgrading and modernization of exemptions in these

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5. *See* Appendix B for a comparison of essential provisions under the 1978 Act and the 1898 Act, as amended.

states. *See* Appendix A. Thus, 32 of the 34 states which have "opted out" to date have substantially enhanced the "fresh start" available to debtors within those jurisdictions. Where a state has "opted out", of course, debtors are subject only to state exemption provisions in any event. Most of the remaining 16 states which have not "opted out" had exemptions which were similar to or more liberal than the federal ones to begin with. *See* Appendix A. California, for example, allows a $45,000 homestead and Kansas, Minnesota and Florida have almost unlimited homesteads. It is hard to contend, therefore, that debtors would be harmed by revival of the prior Act.

Thus, the principal purpose of the 1978 Act other than the court system has largely been achieved by virtue of the impetus of the Act's provisions. To now have a separate bankruptcy court system, Congress must act anew, but consumer debtors' "fresh starts" have been enhanced by subsequent state legislation and these enhanced exemptions will be effective under the revived Bankruptcy Act of 1898, as amended.

Revival of the prior Act will not burden the district court judges. The referee (judge) will continue to be principally responsible for administering bankruptcy cases, subject only to occasional supervision or "appeal" to the district court judge. The scarcity of resort to such supervision is reflected historically by the fact that bankruptcy "appeals" have constituted a tiny fraction — less than 1% — of the business of the district court judges. *See* Appendix C. Even with the increased bankruptcy caseload, involvement of the district court judges in bankruptcy supervision will remain *de minimus*.

The judgment below should be affirmed on this first alternative ground.

## II.

## THE PERMANENT DESTRUCTION OF PROPERTY AUTHORIZED BY THE GOVERNMENT'S CONSTRUCTION OF SECTION 522(F) EFFECTS AN UNCONSTITUTIONAL TAKING WITHOUT REGARD TO THE SO-CALLED "PUBLIC INTERESTS" THAT ARE ASSERTED.

An alternative ground for affirmance — that the retroactive application of §522(f) would violate the Fifth Amendment — has been confirmed by this Court's analysis in *Loretto v. Teleprompter Manhattan CATV Corp.* ____ U.S. ____, 102 S.Ct. 3164 (June 28, 1982).

The government argues that the application of §522(f) to pre-existing secured property does not effect an unconstitutional "taking" because lien avoidance serves the public interest which, in the "balance" of relevant factors, dominates here over the secured party's "mere" interest in property. *See* Brief for the United States, pp. 32-33, citing *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 98 S.Ct. 2646 (1978). The problem with the asserted "justice and fairness" test in a case such as this, however, is that where, as here, a property interest is totally destroyed, the balancing of economic interests is simply irrelevant. If the Constitution's protection of private property means anything, it must prevent such destruction. No satisfactory line can be drawn between the destruction here and any other destruction prevented by the Fifth Amendment. The fact Congress may have willed it so is no answer, for that, indeed, is why our Constitutional protections exist; Congress is not and can not be free to define those protections for itself, regardless of the apparent strength of the "public interest" asserted at the moment. *Cf., Railway Labor Executives' Assn.* v. *Gibbons*, ____ U.S. ____, 102 S.Ct. 1169, 1178 (1982); *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155, 164, 101 S.Ct. 446 (1980).

In *Loretto v. Teleprompter Manhattan CATV Corp., supra*, this Court recently reaffirmed the principle that the permanent destruction or occupation of private property is a taking without regard to the small dollar value involved or the arguable justice, fairness or economic impact of the statute. In *Loretto*, a building owner challenged a New York statute which provided that a landlord must permit a cable television (CATV) company to install its CATV facilities upon his property and may not demand payment from the company in excess of the amount determined by a State commission to be reasonable (a onetime $1 payment). Plaintiff alleged that the cables installed on her building pursuant to the New York statute constituted a taking without just compensation. The New York Court of Appeals upheld the statute *on the exact rationale offered by the government here*, that is, that based upon the balancing test of *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 98 S.Ct. 2646 (1978), the law served a legitimate public purpose (eliminating landlord fees and conditions that inhibit development of CATV) with important educational and community benefits, and did not have an excessive economic impact upon the landlord or interfere with any reasonable investment backed expectations. This Court rejected that rationale as *inappropriate* to the permanent physical occupation of property, with respect to which a taking occurs "without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner." 102 S.Ct. at 3176.

*Penn Central Transportation Co.* and similar cases relied upon by the government in *Loretto* and here have established that, with respect to regulations of the *use* of property within the community, the balancing of such factors, including the economic impact and purpose of such a regulation, is significant in determining whether there has been an unconstitutional taking. This Court has often upheld a regulation in the community interest of an owner's *use* of his property (as opposed to its permanent occupation or destruction) where such regulation is deemed necessary to prevent harm to others or provide for the common good. *See Penn Central Transportation Co., supra.* However, as this Court held in *Loretto:*

> At the same time, we have long considered a physical intrusion by government to be a property restriction of an unusually serious character for purposes of the Takings Clause. Our cases further establish that when the physical intrusion reaches the extreme form of a permanent physical occupation, a taking has occurred. In such a case, "the character of the government action" not only is *an* important factor in resolving whether the action works a taking *but is determinative.*

102 S.Ct. at 3171 (emphasis added).

The balancing test of *Penn Central* is thus irrelevant in such circumstances; *Penn Central*, like all the other cases involving regulations of the *use* of property within a community, "does not repudiate the rule that a permanent physical occupation is a government action of such a unique character that *it is a taking without regard to other factors that a court might ordinarily examine.*" *Id.* at 3174 (emphasis added).

The reason for this rule, as this Court pointed out in *Loretto*, is that a permanent physical appropriation of property:

> . . . is perhaps the most serious form of invasion of an owner's property interests. To borrow a metaphor, *cf., Andrus v. Allard*, 444 U.S., at 65-66, 100 S.Ct. at 326-327, the government does not simply take a single "strand" from the "bundle" of property rights: it chops through the bundle, taking a slice of every strand.

102 S.Ct. at 3176.

The total, permanent destruction of Beneficial's security interests effectuated by government authorization[6] through retroactive application of §522(f) is even more unusual and harmful in nature than the permanent physical occupation held to be a taking in *Loretto*. It is not that a few sticks are taken from the

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6. *Loretto* also puts to rest the government's contention that it makes a difference whether the government itself appropriates the property rather than authorizing someone else to do so. See *Loretto*, 102 S.Ct. at 3174, n.9. *Loretto* also vitiates the Seventh Circuit's recent decision in *In re Gifford*, No. 81-1174,—F.2d— (7th Cir., Aug. 18, 1982) *(en banc)*.

bundle; the entire bundle is chopped off and thrown away. Section 522(f) does not merely regulate the use of Beneficial's security interests causing only consequential damage. Rather, "the character of the government action" is to permit a total and permanent destruction of the entire property interest itself. Although each individual item of property affected may be of relatively small value, in the aggregate the impact is devastating. Millions of dollars of security are involved. The lien is avoided on all defined property and Beneficial's interest is wholly extinguished. In these cases, Beneficial would receive nothing for its liens. No compensating shifting of the lien, or priority in distribution is provided. As in *Loretto*, the character of the government action — allowing the permanent destruction of all incidents of property ownership without substitution — is sufficient to establish a taking for which compensation is due, without regard to the purported "public interest" the regulation may serve, the small dollar value of any particular item of security, or the arguable "justice" or "fairness" of the annihilation.

## CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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# Appendix

## APPENDIX A: STATE "FRESH START" EXEMPTIONS

A. States which have enacted homestead and personalty exemptions substantially similar to those provided in the 1978 Bankruptcy Act.

| States | | Statutory Provisions |
|---|---|---|
| (1) | Illinois* | Homestead Exemption — Ill.Rev.Stat. ch. 110, §12-901 |
| | | Personalty Exemption — Ill. Rev.Stat. ch. 110, §12-1001 |
| (2) | Indiana* | Homestead Exemption — Ind. Code §34-2-28-1 |
| | | Personalty Exemption — Ind. Code §34-2-28-1 |
| (3) | Maine* | Homestead Exemption — Me.Rev.Stat.Ann. tit. 14-4552 |
| | | Personalty Exemption — Me.Rev.Stat.Ann. tit. 14-4421 |
| (4) | North Carolina* | Homestead Exemption — N.C. Gen. Stat. §111-1 *et seq.* |
| | | Personalty Exemption — N.C. Gen. Stat. §111-1 *et seq.* |
| (5) | West Virginia* | Homestead Exemption — W.Va. Code ch. 38, Art. 9 |
| | | Personalty Exemption — W.Va. Code ch. 33, Art. 6, 8 |

B. States which have higher homestead and personalty exemptions than those provided in the 1978 Bankruptcy Act.

| States | | Statutory Provisions |
|---|---|---|
| (1) | Minnesota | Homestead Exemption — Minn. Stat. §510.1 |
| | | Personalty Exemption — Minn. Stat. §550.37 |
| (2) | North Dakota* | Homestead Exemption — N.D. Cent. Code §47-18-01 |
| | | Personalty Exemption — N.D. Cent. Code §28-22-01, *et seq.* |
| (3) | Texas | Homestead Exemption — Const., Art. 16, §51 |
| | | Personalty Exemption — Tex. Code Ann. §3836 |
| (4) | Utah | Homestead Exemption — Utah Code Ann §78, C. 23 |
| | | Personalty Exemption — Utah Code Ann §78, C. 23 |

C. States with greater homestead but similar personalty exemptions to those provided in the 1978 Bankruptcy Act.

| States | | Statutory Provisions |
|---|---|---|
| (1) | Arizona* | Homestead Exemption — Ariz.Rev.Stat.Ann. §33-1101, *et seq.* |
| | | Personalty Exemption — Ariz.Rev.Stat.Ann. §33-1101, *et seq.* |

| States | | Statutory Provisions |
|---|---|---|
| (2) | Arkansas* | Homestead Exemption — Ark.Stat.Ann. §30-201, *et seq.* |
| | | Personalty Exemption — Ark.Stat.Ann. §30-201, *et seq.* |
| (3) | California | Homestead Exemption — Cal. Code §1260 |
| | | Personalty Exemption — Cal. Code §690.1 *et seq.* |
| (4) | Colorado* | Homestead Exemption — Colo.Rev.Stat. §38-41-201 |
| | | Personalty Exemption — Colo.Rev.Stat. §13-54-102 |
| (5) | Hawaii | Homestead Exemption — Hawaii Rev.Stat. §651 |
| | | Personalty Exemption — Hawaii Rev.Stat. §651 |
| (6) | Iowa* | Homestead Exemption — Iowa Code §561 |
| | | Personalty Exemption — Iowa Code §627 |
| (7) | Kansas* | Homestead Exemption — Kan.Stat.Ann. §60-2301, *et seq.* |
| | | Personalty Exemption — Kan.Stat.Ann. §60-2301, *et seq.* |
| (8) | Kentucky* | Homestead Exemption — Ky.Rev.Stat. §427.040 *et seq.* |
| | | Personalty Exemption — Ky.Rev.Stat. §427.040 *et seq.* |
| (9) | Louisiana** | Homestead Exemption — La.Rev.Stat. Ann. T. 20-§1 |
| | | Personalty Exemption — La.Rev.Stat.Ann. T. 13-§3881 |
| (10) | Maryland* | Homestead Exemption — Md. Code Ann. §11-504 |
| | | Personalty Exemption — Md. Code Ann. §11-504 |
| (11) | Massachusetts | Homestead Exemption — Mass.Gen.Law Ann. §188 |
| | | Personalty Exemption — Mass.Gen.Law Ann. §175 |
| (12) | Michigan | Homestead Exemption — Mich.Comp.Laws Ann. §600.4301 |
| | | Personalty Exemption — Mich.Comp.Laws Ann. §600.4301 |
| (13) | Mississippi | Homestead Exemption — Miss. Code Ann. §85-3-1, *et seq.* |
| | | Personalty Exemption — Miss. Code Ann. §85-3-1, *et seq.* |
| (14) | Nebraska* | Homestead Exemption — Neb.Rev.Stat. §40-§101 |
| | | Personalty Exemption — Neb.Rev.Stat. §25-§1551 |
| (15) | Nevada* | Homestead Exemption — Nev.Rev.Stat. §115-010 |
| | | Personalty Exemption — Nev.Rev.Stat. §21-090 |
| (16) | New Hampshire* | Homestead Exemption — N.H.Rev.Stat. §480, §1 |
| | | Personalty Exemption — N.H.Rev.Stat. §511, §2 |
| (17) | New Mexico | Homestead Exemption — N.M.Stat. Ann. §42-10-9 |
| | | Personalty Exemption — N.M.Stat.Ann. §42-10-2 |
| (18) | New York* | Homestead Exemption — N.Y. Civ. Prac. Law §5206 |
| | | Personalty Exemption — N.Y. Civ. Prac. Law §5205 |
| (19) | Oregon* | Homestead Exemption — Or.Rev.Stat. §23.240 |
| | | Personalty Exemption — Or.Rev.Stat. §23.160 |

| States | | Statutory Provisions |
|---|---|---|
| (20) | South Carolina* | Homestead Exemption — S.C. Code Ann. §15.-41-10 |
| | | Personalty Exemption — S.C. Code Ann. §15-41-310 |
| (21) | South Dakota* | Homestead Exemption — S.D. Codified Laws Ann. §43-45-3 |
| | | Personalty Exemption — S.D. Codified Laws Ann. §43-45-1 |
| (22) | Tennessee* | Homestead Exemption — Tenn. Code Ann. §26-2-301 |
| | | Personalty Exemption — Tenn. Code Ann. §26-2-101 |
| (23) | Virginia* | Homestead Exemption — Va. Code §34-4 |
| | | Personalty Exemption — Va. Code §38-26 |
| (24) | Wisconsin | Homestead Exemption — Wis.Stat. §815.20 |
| | | Personalty Exemption — Wis.Stat. §815.01, *et seq.* |

D. States with greater homestead but lesser personalty exemptions (or vice versa) than those provided in the 1978 Bankruptcy Act.

| States | | Statutory Provisions |
|---|---|---|
| (1) | Alabama* | Homestead Exemption — Ala. Code §6-10-2, *et seq.* |
| | | Personalty Exemption — Ala. Code §6-10-2, *et seq.* |
| (2) | Alaska | Homestead Exemption — Alaska Stat. §9.35.080, *et seq.* |
| | | Personalty Exemption — Alaska Stat. §9.35.080, *et seq.* |
| (3) | Connecticut | Homestead Exemption — Conn. Gen. Stat. §52-352, *et seq.* |
| | | Personalty Exemption — Conn. Gen. Stat. §52-352, *et seq.* |
| (4) | Florida** | Homestead Exemption — Const., §10, Art. 4(a) |
| | | Personalty Exemption — Fla. Stat. §222.13, *et seq.* |
| (5) | Idaho* | Homestead Exemption — Idaho Code §55-1101 |
| | | Personalty Exemption — Idaho Code §11-601 |
| (6) | Montana* | Homestead Exemption — Mont. Code Ann. §70-32-101 |
| | | Personalty Exemption — Mont. Code Ann. §25-13-601 |
| (7) | Ohio* | Homestead Exemption — Ohio Rev. Code Ann. §2329.73 |
| | | Personalty Exemption — Ohio Rev. Code Ann. §2329.61 |
| (8) | Oklahoma* | Homestead Exemption — Okla.Stat. §31.1, *et seq.* |
| | | Personalty Exemption — Okla.Stat. §31.1, *et seq.* |
| (9) | Vermont | Homestead Exemption — Vt.Stat.Ann. §27-101 |
| | | Personalty Exemption — Vt.Stat.Ann. §12-2740 |
| (10) | Washington | Homestead Exemption — Wash. Rev. Code §6.12.010 |
| | | Personalty Exemption — Wash. Rev. Code §6.16.020 |

E. States which have enacted substantial homestead and/or personalty exemptions both of which, however, are lower than those provided in the 1978 Bankruptcy Act.

| States | | Statutory Provisions |
|---|---|---|
| (1) | Delaware* | Homestead Exemption — Del. Code Ann. §10-4901, *et seq.* |
| | | Personalty Exemption — Del. Code Ann. §10-4901, *et seq.* |
| (2) | Georgia* | Homestead Exemption — Ga. Code §15-101, *et seq.* |
| | | Personalty Exemption — Ga. Code §15-101, *et seq.* |
| (3) | Missouri* | Homestead Exemption — Mo. Rev. Stat. §513.430, *et seq.* |
| | | Personalty Exemption — Mo. Rev. Stat. §513.430, *et seq.* |
| (4) | New Jersey*** | Homestead Exemption — no provision |
| | | Personalty Exemption — N.J. Rev. Stat. § 2A, C. 17, §19 |
| (5) | Pennsylvania*** | Homestead Exemption — no provision |
| | | Personalty Exemption — Pa. Cons. Stat. §42-8123 |
| (6) | Rhode Island*** | Homestead Exemption — no provision |
| | | Personalty Exemption — R.I. Gen. Laws %9-26-4 |
| (7) | Wyoming** | Homestead Exemption — Wyo. Stat. §1-20-101 |
| | | Personalty Exemption — Wyo. Stat. §1-20-105 |

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* Denotes those states which upgraded their exemption provisions after opting out of the 1978 Bankruptcy Act.

** Denotes those states which opted out of the 1978 Bankruptcy Act without altering their existing exemptions.

*** Denotes those states in which opt-out legislation is presently pending.

## APPENDIX B: OVERALL COMPARISON, 1978 ACT WITH PRIOR LAW

### Eligibility

Except for minor, largely technical differences in eligibility, the same persons are eligible for bankruptcy relief under both the 1978 Act and the 1898 Act, as amended. Compare §109 of the 1978 Act with the previous Act §§ 2(a), 2(a)(1) and Bankruptcy Rule 116, §4(a), §59, ch. IX, §§126(3), 306(3), 406(6), 606(3)(a). Both Chapter 7 of the 1978 Act and Chapter VII of the prior Act are essentially unrestricted liquidation proceedings. Compare §109(b) of the 1978 Act with §4 of the previous Act. Chapter 11, the 1978 Act's reorganization chapter, is a compilation of the three reorganization chapters of the prior Act, Chapters X, XI, and XII, (together with the rules and case law thereunder) with almost identical eligibility criteria. Compare §109(b) and (d) of the 1978 Act with §§306(3), 126, 106(3), and 406(6) of the previous Act. With some minor differences in eligibility,[1] the same individuals are eligible for the composition and extension repayment plans of both the prior and the 1978 Acts.

### Relief

In addition, the same relief is granted under both the 1898 and 1978 Acts. Both contemplate the discharge or reorganization of debts; both have the same essential form and substance. Compare §727 of the 1978 Act (described in House and Senate Reports as the "heart of the fresh start provisions of the bankruptcy laws;"

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1. Chapter XIII of the prior Act was available to "an individual whose principal income is derived from wages, salary or commissions." §606(3) and (8). The 1978 Act is available to an individual with regular income and certain unsecured debts which do not exceed $100,000, plus certain secured debts which do not exceed $350,000. §109e. Small business proprietors not eligible for relief under the previous Act Chapter XIII, however, would be eligible for relief under the previous Chapter XI which dealt primarily with extension and composition of unsecured debt. §306(3).

H.R. 95-545, 1st Sess., 84; S.R. 95-989, 2nd Sess., 98), with §§14C and 15 of the previous Act; §1141 of the 1978 Act with the previous Act §§224, 226, 474, 228, 14a (proviso), and Rule 405; and §1328 of the 1978 Act with Rule 13-404 and previous Act §§14b, 58b, 60 and 661.

**Operating Principles**

Apart from the "fresh start" exemptions discussed in the text and Appendix A, and the unconstitutional court system, the operating principles under the two acts are virtually identical. Compare, respectively, §§301, 502 and 704 of the 1978 Act with §§2a (24), 57 (and Rules 306(a) and (b), 301(a) and 304), 68a, 63a(1), (5) and (9), 202, 353, 458, and 47a. With the exception of the shift in function of the referee (judge) to a less administrative mode (as reflected in the "notice and hearing" provisions discussed in the text) and minor other exceptions, the 1978 Act simply brought together the essential rules and provisions formerly found in three principal sources: (1) the provisions of the 1898 Act, as amended; (2) the Bankruptcy Rules, and (3) well developed lines of case law. The 1978 Act's provisions, and their prior sources, are described in 3 1981 Collier Pamphlet Edition Bankruptcy Code, comments and commentary therein.

## APPENDIX C

### U.S. DISTRICT COURT JUDGE CASELOADS

| Year (thru June 30) | Total Cases Filed* | Appeals From Referee (Judge) to District Court Judge | Bankruptcy "Appeals" As % of District Court Judges' Total Caseloads |
|---|---|---|---|
| 1977 | 172,031 | 1,257 | 0.7% |
| 1978 | 174,753 | 1,232 | 0.7% |
| 1979 | 187,354 | 1,374 | 0.7% |
| 1980 | 197,710 | 1,406 | 0.7% |

*Includes all civil and criminal cases but does not include bankruptcy filings automatically assigned to referees (judges) per Bankruptcy Rule 102.

*Source: Admin. Office of U.S. Courts, Stat. Div.*

# Appellant's Reply Brief

Office-Supreme Court, U.S.
FILED
SEP 27 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-184

# In the Supreme Court of the United States

OCTOBER TERM, 1982

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UNITED STATES OF AMERICA, APPELLANT

*v.*

SECURITY INDUSTRIAL BANK, ET AL.

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*ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

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## REPLY BRIEF FOR THE UNITED STATES

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REX E. LEE
*Solicitor General*
*Department of Justice*
*Washington, D.C. 20530*
*(202) 633-2217*

## TABLE OF AUTHORITIES

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Cases:

*Ashe, In re*, 669 F. 2d 105, petition for cert. pending, No. 81-1866 (filed Apr. 6, 1982) ..... 2

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*Webber, In re*, 674 F. 2d 796, petition for cert. pending, No. 82-155 (filed July 12, 1982) ..... 1-2, 4, 5

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11 U.S.C. (Supp. IV) 522(f) ..... 1, 2, 3, 4, 5, 6, 8

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Miscellaneous—Continued:

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Note, *Lien Avoidance Under Section 522(f) of the Bankruptcy Code: Is Retrospective Application Constitutional?*, 49 Fordham L. Rev. 615 (1981) ..... 2, 4

# In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 81-184

UNITED STATES OF AMERICA, APPELLANT

*v.*

SECURITY INDUSTRIAL BANK, ET AL.

*ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

## REPLY BRIEF FOR THE UNITED STATES

1. Appellee Beneficial Finance contends briefly (Br. 24-25) that no constitutional question is presented in this case because Section 522(f) "may not have been intended to be applied" retrospectively. The timidity with which Beneficial proffers this contention is understandable, because it is totally without foundation. The court below flatly rejected the argument that the statute should be so interpreted (J.S. App. 7a-9a), as has every other court of appeals that has considered the question. See *In re Gifford*, No. 81-1174 (7th Cir. Aug. 18, 1982) (en banc);[1] *In re Webber*, 674 F. 2d 796,

[1]A panel in *Gifford* originally held by a 2-1 vote that Section 522(f) was not intended to apply retrospectively (669 F. 2d 468 (1982)), but that decision was reversed en banc by a vote of 7-1. The en banc Seventh Circuit also held that Section 522(f), as so construed, is constitutional, adopting the arguments presented by the government in this case. We are lodging ten copies of the en banc opinion in *In re Gifford* with the Clerk of this Court.

801-802 (9th Cir. 1982), petition for cert. pending, No. 82-155 (filed July 12, 1982); *In re Ashe*, 669 F. 2d 105 (3d Cir. 1982), petition for cert. pending, No. 81-1866 (filed Apr. 6, 1982). Bankruptcy courts and commentators have also agreed that Section 522(f) was intended to apply retrospectively. See *In re Gifford, supra*, slip op. 5; Note, *Constitutionality of Retroactive Lien Avoidance Under Bankruptcy Code Section 522(f)*, 94 Harv. L. Rev. 1616, 1619 n.20 (1981); Note, *Lien Avoidance Under Section 522(f) of the Bankruptcy Code: Is Retrospective Application Constitutional?*, 49 Fordham L. Rev. 615, 622-626 (1981).

The statute itself is quite clear on this point. Section 402(a) of the transition provisions of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, Title IV, 92 Stat. 2682, provides that "[e]xcept as otherwise provided in [Title IV], the Act shall take effect on October 1, 1979." One specific exception to this provision is the savings clause, Section 403(a) of the Act, 92 Stat. 2683, which provides that the preexisting bankruptcy law will continue to apply to cases commenced before October 1, 1979. But cases commenced after that date, such as the ones involved here, are governed by the new Bankruptcy Reform Act; the Act provides no exceptions to that rule that depend upon the date on which a particular creditor's security interest was created. As noted in our opening brief (U.S. Br. 15-16), such retrospective application to preexisting creditors' interests accords with the usual operation of bankruptcy legislation. See, *e.g., Dickinson Industrial Site, Inc.* v. *Cowan*, 309 U.S. 382, 383 (1940).

Beneficial's argument (Br. 24-25) that the Act should not be construed to apply retrospectively rests entirely on the fact that a draft of the savings clause contained in one of the early bills introduced in the House of Representatives contained an additional clause specifying the irrelevance of "the

date of occurrence of any of the operative facts determining" the rights of the parties (Beneficial Br. 25). Citing a statement made by one private practitioner, William Plumb, in the course of the House hearings on the bill in 1976, which suggested that retrospective application of some provisions might raise constitutional questions, Beneficial theorizes that Congress changed the language of the savings clause in response to this statement in order to eliminate *any* retrospective effect of the Act and hence avoid any constitutional problems.

This theory is sheer speculation. Mr. Plumb was one of many witnesses to testify before Congress, and his statement concerning the constitutional problems of retrospectivity, which, incidentally, was narrowly focused on provisions other than Section 522(f),[2] was only a small portion of his extensive testimony on the entire bill. There is no indication in the legislative history that the final version of the savings clause was intended to address Mr. Plumb's concerns by eliminating the retrospective effect of the Act; rather, it was simply the product of one of the countless changes made in the course of the drafting process for brevity and other reasons. See Klee, *Legislative History of the New Bankruptcy Law*, 28 De Paul L. Rev. 941, 945-947

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[2]Beneficial hints (Br. 25-26 n.20) that Congress might have been concerned about the constitutionality of retrospective application of Section 522(f) by noting that the House Report on the Act cites *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935), in connection with its discussion of the new exemption section. But the citation to *Radford* in the House Report is not to those portions of *Radford* on which appellees rely for their contention of unconstitutionality, but only to page 583 for the proposition first stated in *Long* v. *Bullard*, 117 U.S. 617 (1886), that a valid lien on exempt property is not discharged by the bankruptcy proceeding—a rule not disturbed by Section 522(c). See H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 361 (1977); U.S. Br. 20 n.10. The citation thus does not suggest any concern by Congress that Section 522(f) would be unconstitutional if applied retrospectively. See *In re Gifford*, *supra*, slip op. 6-7 n.3.

(1979). See generally *In re Gifford, supra*, slip op. 5-7. Indeed, the discussions of the transition provisions in the legislative history seem to assume that the new Act would apply in full to proceedings commenced after October 1, 1979, and they make no mention of any limitation based on the date on which certain rights were created. See, *e.g.*, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 287-288 (1977); 124 Cong. Rec. 32412 (1978) (remarks of Rep. Edwards); 124 Cong. Rec. 34011 (1978) (remarks of Sen. DeConcini). See generally Note, *Lien Avoidance, supra*, 49 Fordham L. Rev. at 624-626.

There is no reason to impute to Congress an intent to eliminate the retrospective effect of the statute. As explained in our opening brief (U.S. Br. 22-25), in light of the compelling need for bankruptcy reform, it would have been irrational for Congress to have eliminated the retrospective effect of Section 522(f), thus perpetuating for many years practices found undesirable. See *In re Webber, supra*, 674 F. 2d at 802 n.11. A fortiori, it would have been irrational for Congress to have eliminated the retrospective effect of the entire statute, as appellee Beneficial contends; that would have rendered largely illusory, for a substantial period of time, the provision making the new law applicable to proceedings commenced after October 1, 1979. Moreover, because the old bankruptcy law was repealed except for proceedings commenced before October 1, 1979 (Pub. L. No. 95-598, Section 401, 92 Stat. 2682), interpreting the statute not to apply retrospectively would leave no bankruptcy law applicable to rights created before October 1, 1979. See J.S. App. 7a-9a. Congress could not have intended such a perverse result.[3]

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[3]Beneficial correctly states (Br. 26 n.20) that, at least with respect to the liens involved in this case, state law could fill the gap. But the Bankruptcy Reform Act generally specifies those areas in which Congress intended state law to apply. See, *e.g.*, 11 U.S.C. (Supp. IV)

Finally, the fact that retrospective application of Section 522(f) raises a constitutional question is no justification for construing the statute contrary to "the natural meaning of its words" (*United States* v. *Lindsay*, 346 U.S. 568, 571 (1954)). Indeed, such a construction would work a greater interference with the congressional intent in enacting Section 522(f) than would a holding that retrospective application of that section is unconstitutional. If Section 522(f) is construed as having no retrospective application, then it does not apply even to liens created during the 11-month period between the enactment of the Bankruptcy Reform Act and its effective date, even though creditors holding such liens were on notice of the passage of the Act and could not seriously contend that Section 522(f) is an unconstitutional interference with their investment-backed expectations. See *In re Webber, supra*, 674 F. 2d at 804 (Schroeder, J., concurring). Because Congress clearly made application of the Bankruptcy Reform Act retrospective, the question of the constitutionality of the application of Section 522(f) to pre-enactment liens is properly presented in this case.

2. The crux of appellee Beneficial's constitutional argument is that the Fifth Amendment prohibits Congress from "impair[ing]" property rights (Br. 16); hence, because its blanket liens in debtors' household goods can be characterized as a property interest, the lien avoidance provision of Section 522(f) must be unconstitutional. But of course it is only a "taking" of property without just compensation that violates the Fifth Amendment; a substantial impairment of property rights does not necessarily constitute a "taking." For example, a rent control law that permits tenants to remain in possession of their apartments after the termination of their leases (*Block* v. *Hirsh*, 256 U.S. 135 (1921))

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522(b)(1) (debtor may choose state exemptions). Congress surely would have stated so explicitly if it had wanted state law to play such a crucial role in the transition period.

and a prohibition on the operation of gold mines (*United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (1958)) were constitutional although they clearly effected a substantial economic impairment of property rights.

By the same token, Beneficial's characterization of Section 522(f) as "command[ing] A to relinquish his property interest and *give it to B*, to the benefit of both the debtor and other creditors" (Br. 23; emphasis in original) fails to establish that the statute constitutes a taking. First, the characterization is not accurate. While Section 522(f) does permit a bankrupt debtor to avoid the fixing of a nonpossessory, nonpurchase-money lien on certain of his exempt property, the creditor does not give his lien to anyone; moreover, it is unclear how other creditors are benefited by the operation of Section 522(f). Second, and more important, almost any economic regulation can be characterized as causing a transfer of property between individuals. For example, when Congress increases the minimum wage level, the direct result is that property, in the form of money, is transferred from some employers to their employees. Clearly, such legislation, which, like bankruptcy legislation, is part of a "public program adjusting the benefits and burdens of economic life to promote the common good," does not effect an unconstitutional taking. See *Penn Central Transportation Co.* v. *New York City*, 438 U.S. 104, 124 (1978); cf. *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976).[4]

Rather, there is no "set formula" for determining whether a particular governmental action constitutes a taking; the determination depends upon an analysis of certain factors

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[4]Thus, Beneficial's suggestion (Br. 12) that Section 522(f) is not legislation for a public purpose because it benefits debtors at the expense of creditors is frivolous.

identified by this Court in *Penn Central Transportation* v. *New York City, supra* (see U.S. Br. 32-33, 37). An important ingredient in this analysis is the nature of the property interest involved. The arguments of both appellees fail to recognize the fact that the liens involved here are the weakest kind of property interest imaginable; indeed, they are hardly an interest in property at all.[5] As explained in our opening brief (U.S. Br. 36-44), these nonpossessory, nonpurchase-money blanket liens in household goods[6] are valuable because they provide a credible threat of repossession of the debtor's basic necessities in order to compel him to pay his debt. The lienholder has little interest in possession of the secured household goods; as a practical matter, because of their minimal market value, it is not worthwhile actually to repossess them. See *In re Gifford, supra*, slip op. 18 & n.12. Indeed, unlike the ordinary security interest, the value of the collateral is not an important factor in determining the amount of credit that a finance company is willing to lend. See U.S. Br. at 41-42 n.22.[7] The fact that the liens do not represent a genuine interest in the possession of property strongly militates against finding a taking; the

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[5]For this reason, *Loretto* v. *Teleprompter Manhattan CATV Corp.*, No. 81-244 (June 30, 1982), is of little help to appellees. The Court repeatedly emphasized that *Loretto* involved a permanent physical occupation of realty, "perhaps the most serious form of invasion of an owner's property interest." Slip op. 15.

[6]Although Beneficial suggests (Br. 14 n.9) that its liens here are not blanket liens because the security agreements list some specific items (such as silverware, plastic dishes, and a toaster), the agreements explicitly provide that the security for the loan is "all household goods * * * of every kind."

[7]By contrast, the amount of the loan in *Radford* clearly was dependent on the value of the mortgaged farm, and the farm itself undoubtedly benefitted from the loan. See *In re Gifford, supra*, slip op. 15. Thus, whether or not the outstanding loan was the first mortgage on the farm or a refinancing (see Beneficial Br. 19), the mortgage was a much stronger property interest than the lien involved here.

Fifth Amendment does not require compensation for the extortion value of a security interest. See generally *In re Gifford, supra*, slip op. 15-20. This factor, coupled with the nature of the governmental action as a broad-based bankruptcy reform for the common good (see U.S. Br. 33-36) and the fact that the statute does not destroy creditors' security interests (see *id.* at 44-45), strongly supports the constitutionality of the retrospective application of Section 522(f).

3. On January 11, 1982, this Court denied appellee Beneficial's motion to enlarge the question presented in this appeal to encompass whether Article III of the Constitution prohibits the bankruptcy courts from exercising jurisdiction over the instant cases. Beneficial also sought to raise this issue by means of a cross-appeal, No. 81-583, but the Court has not acted on that cross-appeal. Undaunted, Beneficial has devoted the bulk of its argument (Br. 26-46; Supp. Br. 3-14) to the contention that the bankruptcy courts' exercise of jurisdiction in these cases was unconstitutional. For the reasons stated in our response to the cross-appeal, that issue is not properly before the Court.[8] In any event, there is no merit to the contention that Article III prohibits bankruptcy courts from exercising the traditional bankruptcy jurisdiction exercised here, which had been exercised by bankruptcy referees for many years prior to the enactment of the Bankruptcy Reform Act of 1978.

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[8]In addition, assuming arguendo that Beneficial's constitutional objections have some merit, this Court's holding that its decision in *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, No. 81-150 (June 28, 1982), has only prospective effect (slip op. 38) indicates that the action of a bankruptcy court, even if its exercise of jurisdiction is later held to violate Article III, will not be overturned when jurisdiction is challenged for the first time in this Court. See *Barnes* v. *Whelan*, No. 81-1535 (D.C. Cir. Sept. 3, 1982), slip op. 4-5 n.1.

For the foregoing reasons and the reasons set forth in the government's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

REX E. LEE
*Solicitor General*

SEPTEMBER 1982

DOJ-1982-09

# Docket Sheet

| NO. 81-184-AFX (Vide: 81-583) | TITLE | United States, Appellant v. Security Industrial Bank, et al. |
|---|---|---|

| DOCKETED | COURT |
|---|---|
| July 29,1981 | United States Court of Appeals for the Tenth Circuit |

| DATE | PROCEEDINGS AND ORDERS |
|---|---|
| | Counsel for Appellant: Solicitor General |
| | Counsel for Appellees: Michael E. Katch, Abe Fortas Henry F. Field, Melvin I. Orenstein, Charles S. Cassis |
| May 20, 1981 | Application for an extension of time to docket an appeal and order granting same until July 30, 1981 by White, J, on May 21, 1981. |
| July 29,1981 | Statement as to jurisdiction filed. (Record filed) |
| Sept. 16, 1981 | DISTRIBUTED 10/9/81. |
| Sept. 25, 1981 | * Motion of appellee Beneficial Finance of Kansas, Inc. to enlarge questions presented filed. |
| Sept. 25, 1981 | Motion to consolidate No. 81-583 and No. 81-184 with No. 81-150. (Also in 81-583). |
| Oct. 2, 1981 | Response Requested. |
| Oct. 5, 1981 | Response to motion to consolidate filed. (Also in 81-583). (by Northern Pipeline Construction Company) |
| Oct. 7, 1981 | Opposition to motion to consolidated filed by Marathon Pipeline Company. (Also in 81-583). |
| Oct. 30, 1981 | Order extending time to file a response to the jurisdictional statement until Nov. 16, 1981. |
| Nov. 2, 1981 | Memorandum of appellee Beneficial Finance of Kansas, In . in support of Jurisdictional Statement filed. |
| Nov. 16, 1981 | Motion to affirm filed. |
| Nov. 24, 1981 | DISTRIBUTED. 12-11 |
| Dec. 14, 1981 | The motion of Beneficial Finance of Kansas, Inc. to consolidate this case with No. 81-150, Northern Pipeline Construction Co. v. Marathon Pipe Line Co.; No. 81-546, United States v. Marathon Pipe Line Co.; and No. 81-583, Beneficial Finance of Kansas, Inc. v. United States, is DENIED. Probable jurisdiction NOTED |
| | --- |
| Dec. 24, 1981 | Motion of Solicitor General to defer brief and oral argument filed. |
| Jan. 4, 1982 | DISTRIBUTED. 1-8. (Above motion) *(Also motion filed 9/25/810 |
| Jan. 5, 1982 | Opposition of Beneficial Finance of Kansas, Inc. to above motion filed. |
| Jan. 11, 1982 | The motion of appellee Beneficial Finance of Kansas, Inc. to enlarge questions presented is DENIED. The motion of the Solicitor General to defer briefing and oral argument is DENIED. |
| | (Over) |

81-184

*Title*

No.

| DATE | PROCEEDINGS AND ORDERS |
|---|---|
| Jan. 11, 1982 | Order extending time to file the joint appendix and Government's brief on the merits until Feb. 10, 1982. |
| Feb. 10, 1982 | Motion to dispense with printing the joint appendix filed |
| Feb. 22, 1982 | Brief for the appellant, United States, filed. |
| Feb. 23, 1982 | DISTRIBUTED. 2-26. (Motion to dispense with printing joint appendix). |
| Mar. 1, 1982 | The motion of the Solicitor General to dispense with printing the joint appendix is GRANTED. |
| Mar. 16, 1982 | Motion of Security Industrial Bank for divided argument and for additional time for oral argument filed. |
| March 26, 1982 | Order extending time for ALL APPELLEES to file their briefs on the merits until Apr. 2, 1982. |
| Mar. 29, 1982 | The motion of Security Industrial Bank for divided argument and for additional time for oral argument is DENIED. |
| Mar. 31, 1982 | Brief for appellee Beneficial Finance of Kansas, Inc. filed. |
| Mar. 31, 1982 | Brief for appellees Security Industrial Bank and Liberty Loan Corporation filed. |
| Apr. 9, 1982 | Motion of appellee Beneficial Finance of Kansas, Inc. to schedule oral argument during April 1982 session filed. |
| Apr. 13, 1982 | DISTRIBUTED. 4-16. (Above motion). |
| Apr. 19, 1982 | The motion of appellee Beneficial Finance of Kansas, Inc. to schedule oral argument during April, 1982 session is DENIED. |
| Aug. 5, 1982 | CIRCULATED. |
| Sept. 17, 1982 | Supplemental brief of appellee Beneficial Finance of Kansas, Inc. filed. (D). |
| Sept. 27, 1982 | Reply brief for the United States filed. (D). |
| Oct. 6, 1982 | ARGUED. |